

No. 12391

United States
Court of Appeals
For the Ninth Circuit.

AGNES M. KANNE, Executrix under the will and of the Estate
of Fred H. Kanne, Collector of Internal Revenue of the
United States for the District of Hawaii,

Appellant,

vs.

AMERICAN FACTORS, LIMITED, an Hawaiian Corporation,
Appellee.

and vs.

AMERICAN FACTORS, LIMITED, an Hawaiian Corporation,
Appellant,

vs.

AGNES M. KANNE, Executrix under the will and of the Estate
of Fred H. Kanne, Collector of Internal Revenue of the
United States for the District of Hawaii,

Appellee.

Transcript of Record
In Two Volumes
Volume II
(Pages 227 to 622)

Appeals from the United States District Court,
District of Hawaii.

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PAUL P. O'BRIEN,

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Mr. Wild: Your Honor said he wanted to recess until what hour?

The Court: I think about two o'clock. Is that satisfactory?

Mr. Atherton: Yes.

The Court: All right.

(The Court recessed at 12:33 p.m.) [65]

Afternoon Session

(The Court reconvened at 2:00 p.m.)

Mr. Wild: Is Your Honor ready to proceed?

The Court: Yes. We had finished with stipulation No. 2. There was another stipulation.

Mr. Wild: Not in this case, Your Honor. I had thought we would go ahead on the Hackfeld litigation issue first and then later on, when we complete that, later on go into the other stipulation. At this time I would like to make something in the nature of a brief statement of our position.

The Court: Yes.

Mr. Wild: In this connection, hoping that it might be of help to Your Honor, I prepared a preliminary statement of some of the leading authorities, not all, that we relied on. And I also prepared excerpts from the regulations of the U. S. Treasury Department, Bureau of Internal Revenue. Might I state first, Your Honor, that all of the issues arise under the Revenue Act of 1932; that Treasury regulations 77 were issued by the Bureau of Internal Revenue, U. S. Treasury Department, on the Revenue Act of '32.

Now, I have brought up here, if Your Honor would like to have it——

The Court: Is that '32 retroactive, covering the whole year?

Mr. Wild: Yes, Your Honor, for everyone who in the [66] calendar year 1932—it covered the whole of the calendar year 1932.

The Court: This was a tax return for the year '32?

Mr. Wild: Yes, Your Honor.

The Court: Made subsequent to the end of the year?

Mr. Wild: Yes, Your Honor. Now, in case Your Honor would like to have it available, I have the official publication of the Revenue Act which shows the various provisions of it here, and we are discussing now Section 23(a) of the Revenue Act, the ordinary, necessary expenses of business. Now, I have here furnished for you a copy, and I have given counsel, furnish counsel for the Government with a copy of the regulations 77, which I have here. And if Your Honor would like to use it, I'd be glad to have Your Honor use this in consideration of this. The copy here is a copy of what is there.

The Court: Yes, I know about this in a general way, all the ordinary and necessary expenses of a business.

Mr. Wild: Yes, Your Honor.

The Court: Now, that pertains to what part of your complaint?

Mr. Wild: The Hackfeld litigation.

The Court: The Hackfeld litigation, ordinary expenses?

Mr. Wild: Expenses of business, Your Honor. Our contention is, as shown in our memorandum, and also in our [67] complaint on file, that these expenses are ordinary and necessary expenses allowable under the provisions of Section 23(a) of the Revenue Act of 1932. For Your Honor's information, the provisions of the Revenue Act for many years prior thereto and subsequent thereto were the same, so that the Act so far as this provisions is concerned was the same at all times, I think, from the early twenties up to, I think, the present time.

Now, it is our position, Your Honor, that as all of the expenses of the Hackfeld litigation became obligations which the company has between itself and those others charged with fraud had to pay for the first time in the year 1932, that the amount of those obligations is either an ordinary and necessary expense of the carrying on of the business of H. Hackfeld and Company, Limited, or it is a deferred payment for the assets of H. Hackfeld and Company, Limited, which would then be a capital item of the plaintiff, which plaintiff company set-up is a part of its invested capital. We have outlined the facts as some length this morning.

On the precise question as to whether or not this is an ordinary and necessary business expense within the meaning of that law incurred in carrying on a trade or business, we would call Your Honor's attention to the case of Matson Navigation

Company, Petitioner, versus Commissioner Internal Revenue, Respondent. The Matson Navigation Company was one [68] of the parties charged with fraud. As it was billed by American Factors, Matson Navigation Company paid the expenses of litigation. Matson Navigation Company deducted those expenses of litigation as ordinary and necessary business expenses in the conduct of their business within the meaning of the Revenue Act which was identical in verbiage with the '32 Act. That claim was made, Your Honor, before the conclusion of the case and before it was known who would bear the burden. The Government contested the case on the ground that it was not an ordinary and necessary business expense of the Matson Navigation Company and that they were not entitled to deduct it.

The case itself has two errors of fact in the finding, which, as I take it, so far as our case is concerned, are immaterial on that issue of law. The court says: "The second item in controversy on the payment is the payment made to American Factors, Limited, as petitioner's share of attorney fees and court costs incurred in defending a suit in tort charging fraud and asking damages in the sum of Ten Million Dollars in connection with the purchase of certain German-owned sugar interests in Hawaii. We believe in conclusion that the facts bring this item clearly within the scope of ordinary and necessary business expenses."

And they cite the leading case on that in the U. S. Supreme [69] Court, the Kornhauser case.

The Court: What case?

Mr. Wild: The leading case.

The Court: Yes.

Mr. Wild: It is Kornhauser versus United States, 276 U. S. 145. I believe that I referred to that in our memorandum which I have filed for Your Honor. So that is this case. And it is the Board of Tax Appeals holding that, and they are specialists in tax law, as we both know. They hold that a suit claiming damages for fraud—and our complaint shows that this was a suit claiming damages for fraud—raised issues which when successfully won caused the expenditures of legal expense and other expense in the court to become ordinary necessary business expenses in the conduct of the business.

The Court: Pardon me for interrupting—

Mr. Wild: Go on. I want you to, Your Honor.

The Court: Assuming that the Hackfeld litigants had prevailed, that is, the plaintiff in that case, who would have had to pay the Ten Million Dollars?

Mr. Wild: American Factors would have had to pay the Ten Million Dollars, but because American Factors would have been made liable by the fraudulent act of its agent. Whether or not American Factors could get that Ten Million Dollars back again is a different question. There is no question if the court held that there was fraud, and as the

prayer was that all the assets of Factors be held to answer to the claims, Factors would have been liable to pay the Ten Million. Of course, as between Factors and itself it has a cause of action against the others who fraudulently injured it to make up the payment, you see, Your Honor.

The Court: Well, they have been capable of paying it presumably.

Mr. Wild: Well, I don't know whether they were or not, Your Honor.

The Court: Upon their appraised assets of Seven and One-Half Million, what is that?

Mr. Wild: American Factors had assets of Seven and One-Half Million Dollars; that is, Seven and One-Half Million were paid for them. American Factors, Limited, had only paid that amount, but it did have all the assets of H. Hackfeld and Company, Limited, whatever they might be. And it had assumed all the liabilities. And if they lost the case, it meant the end of American Factors, Your Honor. The whole life of American Factors was at issue in that cause.

The Court: Well, would there have been no liabilities attached on the other defendants?

Mr. Wild: Yes, Your Honor. There are two things that might have occurred there. The first of those is this: if these men who had formulated American Factors had acted [71] fraudulently, the court would have been bound to have given judgment against American Factors for the amount of the fraud, because constructively American Factors

would have been liable for that fraud. Now, as to constructive fraud of its agents who participated in the formation—right at that juncture, if the court so held, then all of the assets of American Factors would have been liable for a judgment. But American Factors would have had a cause of action for whatever damage the fraudulent act of these others had occasioned them.

The Court: Well, wouldn't the property, the assets of every one of the defendants be liable to the extent of the whole?

Mr. Wild: Yes, Your Honor; yes, Your Honor. And so would American Factors.

The Court: Upon execution?

Mr. Wild: Yes, Your Honor.

The Court: So they are all equally liable for Ten Million dollars a piece?

Mr. Wild: No, not a piece.

The Court: I mean until the Ten Million Dollars was paid out of somebody's property.

Mr. Wild: That's right.

The Court: Well, presumably the American Factors would be the easiest one to get your satisfaction of judgment from. [72]

Mr. Wild: That's right.

The Court: That's only an idle presumption because Alexander and Baldwin and Castle and Cooke and the others that were involved, they had assets of equal value. The execution against them would have been just as good as against the American Factors.

Mr. Wild: Well, it might or it might not. I don't know, Your Honor. They didn't pray—they prayed that the execution be as against the interests of these people in American Factors, so far as it was against them.

The Court: In the prayer of the bill?

Mr. Wild: Yes. There isn't any question that this was a suit designed, if won, to break American Factors and get control of American Factors again. There isn't any question about that, because if the judgment of the court had been that the defendants other than Factors who had acted fraudulently, the Factors then would have been responsible for the fraudulent acts of the others in bringing American Factors into being, without any question. And being so responsible, you could collect a judgment or get a judgment against Factors. And in the prayer they asked for judgment against them all, for judgment against the individuals; and asked in that event that Factors be held to be a trustee for the individuals to hold their share in the corporate assets or to hold the stock, whatever interest they have. [73]

The Court: But that wouldn't have relieved the other defendants from their liability.

Mr. Wild: No, Your Honor.

The Court: I just wanted to get that straight.

Mr. Wild: Now, the test on the right of reimbursement there is very clear. The test on the right of reimbursement is whether or not any one of those twenty other defendants got any secret advantage

for themselves out of the transactions other than that which American Factors received. You see, originally there were some 760 or 55 original stockholders. I don't remember the exact number. Of that number, as Your Honor knows, 25,000 shares were allotted to this group of defendants charged in paragraph 20. And they were charged with having occasioned the sale to reap a benefit for themselves as against everyone else in the picture.

After nine months of litigation it was finally held that those 20 did not receive any, not one iota of benefit in addition to what American Factors received or the other shareholders received prorata. And as that was the final holding, which was finally sustained in the year '32, it is our contention there that that foundation, that very factor and the fact that it was a suit in fraud, founds the right of those who paid the expense of the litigation and didn't get any special benefit to demand from American Factors reimbursement for all expenses. [74]

Now, there is one other very interesting question there which is really immaterial now, and Your Honor suggested it this morning, that the litigation actually didn't terminate until the Supreme Court of the United States refused certiorari. But it refused certiorari just after the annual meeting, and as it did, all those factors came into being which made the decision and judgment final in the year 1932. If there had been a reversal, the Government would have had a case. But there was no reversal.

Now, Your Honor, if I might go on just one step

further. I have adverted this morning to the decisions of the U. S. Supreme Court, and I have cited them in this memorandum to Your Honor. The latest expression on ordinary and necessary business expense is that, I believe, of Commissioner of Internal Revenue versus Heininger. That is cited on page 3 of our memorandum. That is in 88 Law Edition, 171. I won't advert to the foundation behind that case but it was a very important case for this reason: Up until the decision in that case, Your Honor, if the issue had been a fraud claim as against the Government, the courts always denied the deduction as an ordinary and necessary business expense, and in this case they held that combatting fraud claims of the postal department, even though they lost, were ordinary and necessary business expenses deductible as such.

Now, there is another case which adverts to the situation, [75] and which might be of interest to Your Honor, which adverts to the situation where obligations of a prior bankrupt corporation were paid by a successor. That case is Welch versus Helvering, 78 Law Edition, 212. In that case the petitioner had been secretary of a prior corporation which went bankrupt. In order to reestablish his relations with customers whom he had known when acting for the Welch Company, he decided to pay the debts of the Welch Company so far as he was able. He did so and his business prospered. The court cited the statutes in force, and Mr. Justice Cardozo I think has ably stated the rule in that case

as well as it has ever been stated. And he states the rule applicable as follows:

“We may assume that the payments to creditors of the Welch Company were necessary for the development of the petitioner’s business, at least in the sense that they were appropriate and helpful. He certainly thought they were, and we should be slow to override his judgment. But the problem is not solved when the payments are characterized as necessary. Many necessary payments are charges upon capital. There is need to determine whether they are both necessary and ordinary. Now, what is ordinary, though there must always be a strain of constancy within it, is none the less a variable affected by time and place and circumstance. Ordinary in this context does not mean that the payments must be [76] habitual or normal in the sense that the same taxpayer will have to make them often. A lawsuit affecting the safety of a business may happen once in a lifetime. The counsel fees may be so heavy that repetition is unlikely. None the less, the expense is an ordinary one because we know from experience that payments for such a purpose, whether the amount is large or small, are the common and accepted means of defense against attack.”

Then citing *Kornhauser* against the United States, that leading case I referred Your Honor to.

“The situation is unique in the life of the individual affected, but not in the life of the group, the community, of which he is a part. At such times

there are norms of conduct that help to stabilize our judgment, and make it certain and objective. The instance is not erratic, but is brought within a known type."

It covers our case like a glove, except for one thing. In that case everybody admits there was no legal liability of any kind or so upon the taxpayer to pay the debts of a bankrupt firm for which he had been a secretary. He made those payments because he considered they were proper payments to be made. But there was no kind of an obligation, moral, legal or otherwise on him. The court said in that sort of situation, if those payments were not ordinary and necessary expenses of [77] business, they should be treated as capital expenses, and as additional compensation paid for his business.

Now, in our case, may it please the Court, applying this same rule, it is our contention that not only was there a legal obligation, there was an equitable and a moral obligation that arose upon the corporation in '32 to reimburse the expense of the litigation.

Now, I won't again advert to those authorities, Your Honor. I cited some this morning when we were discussing the other case. They are found in my brief. Now I would like to refer for a moment—I might say in passing this, Your Honor, that the Matson Navigation Company case allowed the expense as an ordinary and necessary business expense, in 1932, when the Matson Company was reimbursed the amount of reimbursement as taxable

income to them. The revenues don't suffer. So that Your Honor is not asked to pass upon the question of whether or not the revenues suffer at all. They don't. If these other taxpayers got a deduction and it was allowed, they got a deduction from their return when reimbursement was made, and the reimbursement is taxable income to them. So that the revenues of the United States don't suffer. And there is no equity in the Government's case on that ground.

Mr. Atherton: May I interrupt here a moment?

Mr. Wild: Yes. [78]

Mr. Atherton: I am just wondering if counsel isn't going beyond what I understand to be an opening statement. He is purporting to argue his case when all the evidence is not in yet. I rather think that his statement ought to be limited to what he expects to prove and boil the thing down to those issues. I believe his argument shows that his case is put in.

Mr. Wild: Well, may it please the Court, I just assumed that His Honor wanted the statement of our position and what it was.

The Court: Well, so I do. But it does put opposing counsel at some disadvantage in a matter of argument to present argument as you go along in support of your contentions as to what your case is.

Mr. Wild: I will confine it, Your Honor.

The Court: I think perhaps it would be better to do that in view of the objection.

Mr. Wild: Yes, I'd be very glad to. I had un-

derstood both from counsel and Your Honor that you wanted a pretty full statement of our position.

The Court: Well, I do. And I recall saying that to you when you said that you would open with a rather lengthy opening statement. I expressed my agreeableness to having you do that. But as to argument in support of your position all the way through I think perhaps that you had better defer [79] that.

Mr. Wild: Omit that?

The Court: Yes.

Mr. Wild: Very well. Perhaps I should withdraw my memorandum from counsel because I had anticipated that was what Your Honor wanted.

Mr. Atherton: Do I understand that is to be his trial memorandum, Your Honor? I have read it and it looks to me as if it is rather a complete memorandum. I don't see how it could be amplified very much without writing a book.

Mr. Wild: Well, it has something I knocked off yesterday——

The Court: Which you just put on my desk.

Mr. Wild: And it was just completed today.

The Court: Well, I will read that overnight. Point out the salient things in connection with your contentions or case.

Mr. Wild: It is, then, Your Honor, our contention, after the contention that this is an ordinary and necessary business expense, or it is part of invested capital, that it must be one or the other, that it was all allowable to American Factors in the calendar year 1932 because American Factors was

on the accrual basis. Now, Your Honor, the total expense of the Hackfeld litigation was \$568,607.76. Of that amount we will show that the sum of \$87,992.50 was paid in the year [80] 1932, and that practically none of that expense was known or settled so that the amount of it was in doubt at the beginning of the year 1932. In other words, those were the final expenses, some of which weren't settled until in July when the last item, the biggest item in there, practically the whole amount, was paid as final counsel fees. We will show that, Your Honor.

We will show that under no circumstances could that have accrued in any prior year.

We will also show that of the expenses the sum total of \$396,812.50 of those expenses, that those were expenses already in evidence in part which were paid by the defendants other than American Factors under the agreement; that during a part of the time American Factors had billed and received more in cash from the defendants than the actual expenses which had been paid because they knew there were other items coming; that the balance——

The Court: American Factors had collected from this "hui" \$396——

Mr. Wild: \$396,812.50.

The Court: They collected all that and paid it out?

Mr. Wild: That's right, they collected all that and paid it out. That American Factors, Limited, was in the original meetings made, as it were, the

banker of the group; that is, the American Factors, Limited, were to receive the [81] bills to pay, to pay the bills, but charge all bills to this group; that they carried these items in a deferred account in the books called "Hackfeld Litigation." And that originally there was no agreement at all that this treatment of them would be final. Otherwise the books would not have shown "Hackfeld Litigation." That after the decision in the court by the trial court, the amounts that were paid out were trifling, only some \$80,000, and that there was no billing made on those awaiting the final determination of the case to see what happened. That is, they didn't bill those to the other defendants.

The Court: Although they had paid them?

Mr. Wild: They paid them but they hadn't billed them out of it. Those were waiting in suspense during that period of time.

The Court: There wasn't at any time, or was there—I am asking the question—was there at any time any agreement between this group of stockholders and organizers and American Factors as an entity as to how much these shareholders had agreed to contribute prorata in accordance with the number of shares they owned?

Mr. Wild: Yes, but they agreed to pay all the expenses, not contribute prorata, but to pay all the expenses of the Hackfeld litigation prorata to the shares.

The Court: So that there wasn't any occasion

for any [82] agreement as to what the firm, the corporation, American Factors would pay?

Mr. Wild: No.

The Court: They were to be left free of any expense?

Mr. Wild: Until the final litigation was turned out. Then the question as to whether or not they were to pay the expenses or any part of it was left open. There is no written agreement.

The Court: That is all covered in this—wasn't there some written agreement, wasn't something put in the evidence to show there was a written agreement between these contributors?

Mr. Wild: Yes, there was. That written agreement was this, Your Honor, that if joined as defendants in any suit or suits, they would pay together all of the expenses of the litigation, all of the expenses of the litigation which were approved by the so-called steering committee, or four out of five of them, and the steering committee was A. W. T. Bottomley, Frank Atherton, Richard Cooke and C. R. Hemenway, and they were to pay those expenses prorata to the number of shares that they had originally subscribed, so that if a stockholder owning a half, 25,000 shares, had signed that agreement, and if they had all been sued, then they would have paid all the expenses of the litigation prorata to the number of shares which they subscribed or to the 25,000, as all were sued. [83] So that there wasn't any part of the litigation expense to be shared by American Factors as they went along.

The Court: I see now.

Mr. Wild: These men were charged with fraud, Your Honor, and being charged with fraud motivated them to enter into this agreement to pay all litigation expenses and await final determination to see whether they were busted or whether they were held to be free from fraud, which I take it and I apprehend is a correct view, Your Honor. I think that is the honest and honorable view to take.

Now, then, the request was made, as somebody had to pay the bills, that American Factors as bankers for the group advanced all the money necessary and billed them for it, and then await a final outcome of the litigation to ascertain who was to be reimbursed, you see, or anyone—if they lost the case we admit there would have been no reimbursement.

Now, the next of our contentions there, Your Honor—may I pause just a second? Then, Your Honor, our position under the law concerning reimbursement, I cited this morning in answer to a position taken by Government counsel; and our position there is pretty fully stated on pages 6 through 12 of the memorandum which I presented to Your Honor. Briefly our legal position on that is simply this: as there was a conferring of benefits, and that benefits were conferred alike upon all stockholders of the corporation, or the [84] corporation, that there was raised an obligation under the law pertaining to restitution for American Factors to pay the same.

Our second point on that is this, that even if there was no obligation under the law to pay a nickel of it, there was an obligation in equity, and if there was no obligation in equity then the amount advanced would be a capital item, deferred payment for the assets and businesses of H. Hackfeld and Company, Limited. And we have cited authorities on all those points.

Now, if Your Honor will excuse me a second,—I think I have amply made the skeleton of our position clear to Your Honor—if Your Honor will excuse me a second.

The Court: Yes. Well, it is probably beside anything that is involved here but nevertheless it creates in my mind a passing wonderment: these contributions were made by the several people as set out here on page 15 of the stipulation in different amounts and different years, beginning with 1924 and 1925 and 1926, and I was wondering if these parties, all of whom are no doubt taxpayers, if they had at that time a sufficient confidence or belief in restitution of the amounts. Didn't they return these as expenses, outgoes, in their release with the tax department? Take, for instance, C. Brewer and Company in 1924; they contributed \$10,350; Alexander and Baldwin and Castle and Cooke; and then the following year [85] 1925, \$8,050; and the following year, '25 to '26, \$21,850 a piece. Did they get credit in their tax returns for those outgoes?

Mr. Wild: I don't know, Your Honor. I can

say this, I discussed this case with counsel in Washington. I was told by that counsel that a good many of the contributors had deducted litigation expense and it was allowed on the basis of the Matson case. We also agreed that if I was right in my discussion of the other case, and in any event, when they paid in the money they were under obligation to return it as taxable income in the year in which they got the reimbursement. I mean there isn't any issue about that, and it really has no bearing on our case as far as I can see. Even if these fellows had cheated the Government, I don't think it would have any bearing in our case.

The Court: They probably will come out short-handed if they took deductions over a string of years in smaller amounts and then received the total of their outgo all in one year; they probably paid more tax than they saved by the deductions.

Mr. Wild: They might, Your Honor. It might well be, except for this factor, that during some of those years, Your Honor, rates were going up a little.

The Court: They are going up all the time.

Mr. Wild: They may have paid a little more tax on the income. And actually, after the Government reimburses us it [86] may find that the Government is ahead on that very point that Your Honor has stated, because they collected more tax than these fellows from the reimbursement, than these fellows got as deductions as they went along. But actually that is beside the point on our case,

as I see it. It wouldn't make any difference as to the merits of our case whether these fellows had paid any taxes or not, as I see it. My only point in citing the Matson case was that a technical tax court body that deals with tax court cases had judged where this was a case where it was ordinary and necessary.

The Court: The difference, though, as I see it at a glance, the difference between the Matson Company and the American Factors is that no one had assumed that burden for the Matson Company and it was a necessity to them no doubt.

Mr. Wild: At that time, yes, Your Honor.

The Court: To protect themselves. But in the case of the Factors, it appears to me that it wasn't a necessity on their part because someone else had offered, and there was a protection of their own interests and reputation, and so forth, to carry the burden.

Mr. Wild: Yes, Your Honor. The statement of facts is accurate in part; the understanding, however, was that the issue was to be open. And on the question of law, Your Honor, it is our contention that on the facts as you stated them, and on the authorities as we have cited them, even if there [87] had been no agreement of any kind or sort, the law raised an obligation upon American Factors to pay. And as it was an obligation on their part in that year to pay, that their payment was the ordinary, necessary expense that is contemplated. And even if we are wrong on that, then, Your Honor, under

the Welch case it is our contention that it is an additional capital outlet for the purchasers of the assets and businesses of H. Hackfeld and Company, Limited, which is an additional capital of American Factors.

Now, we rest secure, Your Honor, on the rule of law concerning restitution. I don't want to argue that point now. I merely state my position. The position there is this, Your Honor: Take the case of the ordinary stockholders' suit against officers of a corporation. The officers of the corporation in the first instance pay all the expense of litigation. In that suit where it is directly stockholders, derivative suit or direct stockholders' suit against the officers, the stockholders pray that any benefit is to go into the corporation. Now, when that suit is successfully defended and it is finally held that there was no negligence or other unlawful act of the directors, the law there is that immediately an obligation is raised for the corporation to pay all the expenses of that litigation. And in my memorandum I have cited the authorities on that, too, Your Honor. So that our position is very clear. It is this, that upon [88] conclusion of the litigation, as it was definitely determined that these defendants were not fraudulent, as it was definitely determined they got no benefit other than the benefits which accrued to the corporation as a whole, then under the doctrine of the law of restitution, supported by cases cited, then and for the first time there arose an obligation on the part of American Factors.

Now, American Factors didn't have to submit to suit by these people to determine the question as to whether they had a legal liability. They could make a statement to the stockholders that there were these liabilities. There was a legal liability; there was a moral liability. We will go into that opinion rendered. The minute that the stockholders passed that, it was unnecessary to file litigation.

But it is our contention there that the minute that the stockholders accepted that obligation by the corporation to reimburse these people and pay all the expenses on the basis that they did, there certainly was a clear legal liability in favor of any of these stockholders to get reimbursement. And we didn't have to litigate it in court.

Now, it is also our contention, your Honor, that even if the stockholders had voted No, we wouldn't reimburse a nickel of it, it is our contention, your Honor, that they are then and there obligated, that they there and then accrued the obligation to reimburse under the authorities stated, and [89] to reimburse in full; and that once the court had so determined, there is no question that there would be a deduction.

The Court: It seems to me, my present view of it is, that if there was, as you contend, a legal obligation, liability resting upon factors to pay that expense, that it would amount to this, that they simply had to pay that much more than they had in the beginning expected to pay to gain the ownership free of all claims and encumbrances, that much

more than they had theretofore paid. So that it would be just simply an addition to their capital outlay.

Mr. Wild: Your Honor, that is entirely a possible holding. It would be supported by the Welch case, your Honor. If your Honor finds that this isn't an ordinary and necessary expense of litigation, then in any event it is clearly an additional amount paid for the business, good will and assets of H. Hackfeld and Company. And it is a deferred amount, your Honor.

The Court: I don't want you to gather that I have any firm mind on that. I am raising these for the purpose of getting a better understanding, and not to express any——

Mr. Wild: Yes, I understand that, your Honor. It is either one or the other. It is either an ordinary and necessary business expense allowable in toto in the year '32, or it is an additional amount paid by American Factors as deferred payments for the business and assets of H. Hackfeld [90] and Company, Limited, and a new capital amount to be set up in their books as a capital account, additional cost of Hackfeld assets. Now, your Honor, it is either one or the other. And this case, as I see it, calls upon your Honor to decide which. It is our feeling and our contention that the first view, that is, that it is an ordinary and necessary business expense, is the sound view. That is all, your Honor. But your Honor's question is a very intelligent one there, and your Honor has put your finger, as I see

it, right on the crux of this whole matter, of the matter as I see it. The crux of the matter isn't whether or not we should have paid it. The crux of the matter is, acknowledging that we acknowledged the obligation, should it be capital, additional payment, or should it be ordinary and necessary business expense deductible in the year '32?

Now, your Honor, I must say that I have made a somewhat scattery opening statement, and I'd like now to put on Mr. Lowrey, unless Government counsel wants to make a statement at this time.

Mr. Atherton: Well, all the Government contests at this stage of the proceeding is that its position is that no part of these litigation expenses were ordinary and necessary expenses of the taxpayer, and therefore not properly deductible, and that it does not follow as a necessary corollary from the premise that they are not properly deductible as expenses, that they should be treated as additions or deferred payment on account of the purchase of the assets.

Mr. Wild: Well, what is your alternative, then? If it isn't ordinary and necessary business expense, what is it?

Mr. Atherton: I don't think it is necessary for the Government to state what the alternative is now. We will develop that after the evidence is in.

Mr. Wild: I mean, what your position is.

Mr. Atherton: My position is that it can be a capital item without constituting—a capital expenditure without constituting a cost of acquiring the assets.

Mr. Wild: You mean——

Mr. Atherton: That is perfectly clear. I think you clearly understand the Government's position, don't you, your Honor? That an item can be a capital expenditure and not allowable as deduction as an ordinary and necessary business expense and be capitalized, be treated as a capital expense like, for instance, an organization expense without necessarily constituting a deferred payment on account of the acquisition of the assets; organization expenses, like attorneys fees, and organizing a corporation, and those types of expenditures are not part of the cost of acquiring a business. They are not items to invest in capital whatsoever.

Mr. Wild: Well, I might state in that position, your Honor, that it is clear that attorney fees and other organization [92] expenses are part of the capital of an organization or you can't depreciate them. You consider them as a part of your invested capital, and it is our contention that counsel for the Government picked a pretty poor lemon when he raised his position, because his authorities that he purports to cite don't bear him out. They bear out my contention. Well, anyhow, we will argue that later.

The Court: Well, then, you may proceed with the evidence.

Mr. Wild: How late does your Honor desire to sit tonight?

The Court: Let's have a recess to relieve the reporter.

(A recess was taken at 3:05 p.m.)

After Recess

Mr. Wild: Mr. Lowrey, will you please take the stand.

SHERWOOD M. LOWREY

a witness in behalf of the Plaintiff, being duly sworn, testified as follows:

Direct Examination

By Mr. Wild:

Q. Will you please state your name?

A. Sherwood M. Lowrey, L-o-w-r-e-y.

Q. And where are you a resident?

A. Hilo, Hawaii.

Q. And how long have you been a resident in Hilo?

A. About four months.

Q. And before that where were you a resident?

A. Honolulu.

Q. And for how long?

A. About 60 years.

Mr. Wild: Your Honor, at this time, if counsel has no objection, I'd like to put Mr. Lowrey on simply the Hackfeld issue. I don't want to go into the pension issue or the Henry Waterhouse Trust Company issue until a later time. And if it is agreeable to counsel, it is understood I may recall him?

Mr. Atherton: Yes.

Q. (By Mr. Wild): Were you an officer of American Factors, Limited, Mr. Lokrey?

A. Yes, I was treasurer of the company from

(Testimony of Sherwood M. Lowrey.)

the early part, middle of 1920 until I retired in April of this year.

Q. And during all that time you acted as an officer of the company? A. Yes.

Q. And what was that officer?

A. Treasurer.

Q. Treasurer of the company? In your position as treasurer of the company, did you have anything to do with the Hackfeld litigation?

A. I did.

Q. And will you state your first connection with the [94] Hackfeld claims?

A. When the rumors reached us to the effect that certain of the former shareholders of Hackfeld and Company were going to bring a suit against possibly the company or against a possible group of individuals, it was all very vague when it first reached us. A number of the directors were called together and it was finally decided at that time that it would be necessary for the company to take and secure counsel in order that counsel become acquainted with the facts of the case and be in a proper position to advise the company or the individuals who might be sued.

Q. Was there any discussion with any individuals?

A. That was the first step. Secondly, as these rumors crystalized it then became known, as I remember it, as to who the individuals were that were going to be sued, the individuals and the cor-

(Testimony of Sherwood M. Lowrey.)

porations. And it finally came down to a group, the names of which have been submitted already in this case, as having been the ones who formed the nucleus and made a request for the 27,000 shares or a majority of the stock at the time the company was formed, and who later on were allotted 25,000 shares.

Q. I am calling your attention to the original of an agreement dated July the 29th, 1924—which is the same, for the purposes of the record, your Honor, as Exhibit 1 annexed to Exhibit P-5—and ask you whether you have ever [95] seen the original of that? (Showing a document to the witness.)

A. I have.

Q. And what, if anything, did you do with that original?

A. When it was finally decided or known against whom this suit was to be brought, the signators through this group met and decided it was necessary for them to have counsel. It was indicated that the suit was going to be against them for fraud and conspiracy. It was necessary for them to take and defend themselves. Therefore, it was decided among them that they would take and form this group, “hui” as we use the term here, would take and bear the expenses of defending the suit which was against them in a large part, and to prorate the expenses among themselves in accordance with the number of shares of stock that they had originally either applied for or been allotted, been allotted I think.

(Testimony of Sherwood M. Lowrey.)

Q. Now, did they make any request of American Factors in connection with that agreement?

A. Well, this agreement—there was some 22, as I remember in this agreement. It was necessary for them, in accordance with this agreement, to have a steering committee. The steering committee was, as has been indicated here or stated here, was Mr. Bottomley, Atherton, Hemenway and Cooke. And the gist of the agreement is that this group would underwrite [96] write and pay all the expenses in connection with the defense of this suit as might be determined as properly due by that committee of four that I have just named.

Q. And was American Factors to perform any function in connection—

A. Yes, it then came down to the point, as the litigation developed, it would be necessary for somebody to take and put up the immediate cash to take and pay the bills as the bills were presented rather than going around and trying to collect from the group a certain small amount each time a bill had to be paid. Hence, American Factors acted as a banker for that committee, and as such banker we took and paid the bills as approved by that committee. The committee took and approved all the large bills, and as treasurer of the company I was told to take and settle all minor, ordinary bills, cable expenses and miscellaneous expenses in connection with the suit, which was done. And then, after a considerable amount had

(Testimony of Sherwood M. Lowrey.)

been paid out, we estimated with the number of shares it might take an assessment of two dollars, it might take an assessment of two dollars and a half or it might take an assessment of more than that to collect from this group of 22 an amount that would practically offset the amounts which had already been paid out in order, so to speak, balance this account.

This account was kept merely as a means of convenience [97] for the whole group so a record would be held in one central place as to where the money had gone to, for what purposes it had been used, and, on the other hand, to keep track of the amounts that had come in from the various members of the group, to show the status of the thing at any time that they wanted to try and strike a balance on it.

Q. Now, you mentioned a steering committee. There isn't any such name annexed to anybody in the agreement. Whom do you mean by the steering committee?

A. I mean the four that were named in this to take and handle the matter on behalf of the whole group. In other words, there were 22, as I remember it in there, and it was necessary to have somebody head it all up because some of these individuals were located in San Francisco, some of the corporations were California corporations, and it became necessary to have somebody head the thing

(Testimony of Sherwood M. Lowrey.)

up so that the defense is prepared and set forth to be done in an orderly manner.

Q. Now, at this time I will show you another duplicate of the instrument dated July 28, 1924, and ask you if you have ever seen that before? (Showing a document to the witness.)

Mr. Wild: Through error, I might state, your Honor—I had shown these instruments to counsel—we found that there was another duplicate signed, and I just want to get that one in the record. [98]

A. Yes, Mr. Andrew Welch.

Q. And how many shares opposite his name?

A. One hundred.

Q. Did American Factors sign any copy of this agreement? A. No.

Q. Never? A. They did not.

Q. Now, are any of the men in that so-called steering committee now alive? A. No.

Q. Is it the sense of your testimony that this steering committee directed the litigation, approved the bills kept, routine bills, is that what you have just testified to? A. That is true.

Q. And did you meet with that steering committee at various times?

A. From time to time with members of the committee.

Q. And at the time that this agreement was entered into, was there any agreement between the members, or put it this way—I will withdraw that question. Was there any agreement between Amer-

(Testimony of Sherwood M. Lowrey.)

ican Factors, Limited, and the other defendants who signed this agreement, Exhibit 1 annexed to P-5, as to who was ultimately going to bear the cost of litigation? [99]

A. When it started out the thing was in such a nebulous state, the whole thing, that these men and corporations had to get together to protect and defend themselves. For a long period of time it wasn't known how the outcome of that suit was going to finally end up. In fact, we didn't know it until the appeal to the Supreme Court of the United States—or that legal term that you used there—was denied there. We didn't know who was going to finally have to pay those bills, for the simple reason that if these men had been convicted of fraud——

Mr. Atherton: Excuse me, your Honor, I think his answer now to this extent is not responsive to the question. I move that it be stricken.

The Court: Well, I think the objection is well-grounded. It is not responsive to the question.

Mr. Wild: As I understand the rules of evidence, your Honor, I am the only one that could make the objection, if it is not responsive to the question. So if counsel wants to make a good objection, it is all right with me. That is Jones on Evidence, and I have forgotten the page.

The Court: I think that is perhaps technically right. But the motion to strike could be grounded upon so many other cases.

(Testimony of Sherwood M. Lowrey.)

Mr. Wild: Yes, your Honor.

The Court: I think that the latter part of the statement [100] may be stricken. You have answered the original question?

The Witness: Yes.

Q. How were the payments, as they were made, entered in the books of American Factors?

A. There was one account entitled "Hackfeld Litigation." That account was charged with the monies that were paid out, and that account was credited with the monies that were received.

Q. I think I furnished counsel for the Government with a copy of that itemization. Do you have with you an itemization of that account as it appears in the books of American Factors?

A. I have.

Q. And that was a copy made from the books?

A. It is a copy made from the books, and there is a covering letter bearing my initials in which this or a copy of it was sent to the Internal Revenue Department in 1936.

The Court: May I see that? (Witness hands document to the Court.)

Mr. Wild: I might say that I am putting this in at the request of the United States. The United States said they might object to some items of expenses as not being allowable anyhow.

The Court: Yes. [101]

Mr. Wild: This is an itemized list, and this list was prepared at the request of the United States

(Testimony of Sherwood M. Lowrey.)

and was furnished to the United States, as you testified?

The Witness: According to that covering letter, yes.

Mr. Wild: I would ask that this be received in evidence. And is that P-7?

The Clerk: Yes, P-7.

The Court: Any objection?

Mr. Atherton: No, your Honor, no objection.

The Court: This is an itemized list of accounts of litigation expenses?

The Witness: That is the outgo, Judge, if I may say. That sheet does not show the income.

The Court: Yes.

The Witness: That is the charges against them.

The Court: Yes.

(The document referred to was received in evidence as Plaintiff's Exhibit P-7.)

PLAINTIFF'S EXHIBIT P-7

Admitted

May 12, 1936

Office of the Internal Revenue Agent in Charge,
Honolulu, Hawaii.

Gentlemen:

Attention: Mr. Peterson

In accordance with your verbal request, we are handing you herewith two copies of an itemized

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

list of the Hackfeld Litigation Expenses for the period June 25, 1924, to December 31, 1932.

Yours very truly,

AMERICAN FACTORS,
LIMITED,
S. M. LOWREY,
Treasurer.

SML:EW

Itemized List
Hackfeld Litigation Expense
June 1924 to Dec. 31, 1932

1924

June 25	Auto Hire—Mr. Wirtz.....	\$ 4.00
27	Travel Expense—Mr. & Mrs. Hemenway to San Francisco	400.00
	Travel Expense	7.50
30	Retainer Fee—Lucian H. Boggs.....	1,000.00
	Travel Expense—G. Montgomery to Washington	49.25
July 14	Telephone—N.Y. to Washington.....	12.50
	Cables for June—Honolulu.....	529.90
	Wireless for June—Honolulu.....	83.18
15	Retainer Fee—Pillsbury, Madison & Sutro	7,500.00
18	Fee—C. R. Hemenway.....	2,500.00
18	Travel Expense—C. R. Hemenway.....	575.15
22	Retainer Fee—Henry Holmes.....	2,500.00
23	Travel Expense—C. R. Hemenway & wife San Francisco to Honolulu.....	400.00
23	Freight & Express—Documents S.F. to Washington	5.97
23	Fee—C. R. Hemenway.....	1,000.00
23	Cables for June—New York.....	106.47
31	Photograph of Tax Report.....	10.56
31	Cables for June—S.F.	264.65
31	Fee—Lucian H. Boggs.....	1,000.00
Aug. 15	Wireless—Honolulu	118.20
15	Wireless—Honolulu	6.10
20	Telegrams—S.F.	41.03
20	Travel Expenses Telephone, etc. refunded to Mr. Boggs	1,170.17

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

	30	Cables—S.F.	73.90
	30	Newspapers to Mr. Sutro.....	2.50
Sept.	11	Auto Hire—Mr. Wirtz.....	1.50
	15	Auto Hire—Mr. Wirtz.....	5.00
		Incidentals—S. M. Lowrey.....	4.80
	16	Cables—S.F.	11.75
	22	Cables—Honolulu	185.92
	22	Cables—Honolulu	4.90
	22	Cash advanced to Lucian H. Boggs.....	1,500.00
	26	Fees, Smith, Warren, Stanley & Vitousek....	3,000.00
	30	Cables—S.F.	197.98
	30	Telegrams, Telephone & stenographer— Pillsbury, Madison & Sutro.....	278.14
Oct.	7	Sundries—S. M. Lowrey & A. J. Wirtz.....	1.80
	9	Sundries—S. M. Lowrey & A. J. Wirtz.....	1.50
	11	Newspapers to Mr. Sutro.....	2.00
	15	Sundries—Refund to Mr. Drew, S.F.....	34.55
	21	Cables for Sept.—Honolulu	358.25
	21	Cables for Sept.—Honolulu	13.80
	25	Telephone—Mr. Anderson to Mr. Palmer, S.F. to Boston	114.50
			<hr/>
			Forward.....\$ 25,077.42

[101b]

1924		Forward.....	\$ 25,077.42
Oct.	25	Travel Expense \$406.25 and Telephone & Cables—Pillsbury, Madison & Sutro.....	651.51
		Fees—Pillsbury, Madison & Sutro.....	2,000.00
	31	Cables for Sept.—S.F.....	388.03
Nov.	12	Wireless to G. N. Wileox from Honolulu....	13.20
	12	Wireless to Sutro and A. W. T. Bottomley..	7.92
	12	Travel Expense—Sutro & Atherton to Honolulu	350.00
	18	Travel Expense—O. Sutro.....	350.00
	20	Travel Expense—Sutro to steamer.....	1.50
	24	Travel Expense—A. W. T. Bottomley in S.F.	280.00
	25	Travel Expense—R. H. Trent in S.F.....	125.00
	25	Travel Expense—A. J. Wirtz to S.F.....	135.00
	25	Wireless—Honolulu to Sutro	5.58
	25	Sundries—Suit case for documents	9.23
	26	Travel Expense—Mrs. Hemenway to S.F...	375.00

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

	26	Sundries—Expenses and Insurance on Documents	52.95
	26	Telegrams, telephone & copy work—repaid to Pillsbury, Madison & Sutro.....	521.70
	26	Expense Bill of C. J. Heiser.....	503.00
	29	Cables—Honolulu	463.31
	29	Sundries—Registration Cable address “Oscart”	2.50
	29	Fee—Eberhard Haynes	2,000.00
Dec.	5	Sundries—Newspapers	1.00
		Sundries—Newspapers to Mr. Sutro.....	2.80
	12	Cables—S.F.	455.44
	15	Cables—Honolulu	130.84
	16	Travel Expense—Mr. Hemenway.....	250.00
	16	Fees—Final Payment Lucian H. Boggs.....	8,000.00
	16	Fees—Oscar Sutro	50,000.00
	16	Travel Expense—Oscar Sutro on trip East..	750.00
	16	Travel Expense—Oscar Sutro—Honolulu & return	351.14
	16	Expenses—L. H. Boggs—balance of expenses	71.30
	17	Fees & Expenses—Smith, Warren, Stanley & Vitousek.....	7,113.25
	24	Sundries—Drayage on documents S.F.....	1.50
	24	Cables—C. R. Hemenway's cables to Honolulu	2.80
	24	Expenses—Pillsbury, Madison & Sutro.....	567.27
	27	Expenses—C. R. Hemenway.....	250.00
	27	Expenses—C. R. Hemenway	200.00
	27	Expenses—A. J. Wirtz.....	127.88
	27	Fees—A. J. Wirtz Cash advanced to W. H. Lawrence of Pillsbury, Madison & Sutro..	5,000.00
	31	Expenses—A. W. T. Bottomley.....	620.00
	31	Sundries—Press Clippings—Allens Press Clipping Bureau	3.00
	31	Travel Expenses—R. H. Trent.....	620.00
	31	Travel Expenses—C. R. Hemenway.....	200.00
Forward.....			\$108,031.07

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

1924	Forward.....	\$103,031.07
Dec. 31	Travel Expense—A. J. Wirtz.....	125.00
31	Cables & Wireless.....	96.50
31	Cables & Wireless—Honolulu.....	86.95
31	Sundries—postage, etc.	7.43
31	Expense—C. R. Hemenway.....	100.00
31	Radio—refund to Alexander & Baldwin.....	3.70
Total Expenses 1924.....		<u>\$108,450.65</u>
1925		
Jan. 1	Radio—Frear to Sutro.....	\$ 14.75
20	Travel Expense—F. C. Atherton to S.F.....	125.00
20	Travel Expense—C. R. Hemenway in S.F....	200.00
21	Sundries—Postage	5.58
	Travel Expense—A. J. Wirtz in S.F.....	125.00
	Cables—S.F. to Trent Trust Co.....	11.75
22	Wireless to Hilo.....	6.30
22	Wireless to Kailua	6.60
22	Wireless to Hilo.....	3.75
27	Travel Expense—C. R. Hemenway in S.F....	200.00
27	Travel Expense—A. J. Wirtz in S.F.....	125.00
27	Expenses—Pillsbury, Madison & Sutro.....	609.31
27	Sundries—Press Clippings—Allen's Clipping Bureau	5.88
31	Travel Expense—C. R. Hemenway in S.F....	200.00
31	Radio—Refund Alexander & Baldwin	10.00
31	Travel Expenses—C. R. Hemenway.....	100.00
Feb. 7	Fees—Atherton Richards	500.00
9	Wireless to Hilo.....	3.75
9	Wireless to Kailua.....	3.75
10	Travel Expense—A. W. T. Bottomley in S.F.	620.00
10	Travel Expense—A. J. Wirtz in S.F.....	125.00
13	Cables—S.F.	143.64
18	Travel Expense—W. F. Frear to S.F.....	135.00
19	Expenses—Pillsbury, Madison & Sutro— December & January disbursements.....	2,266.67
19	Radio to Frear.....	6.25
Forward.....		<u>\$ 5,552.98</u>

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

1925	Forward.....	\$ 5,552.98
Feb. 19	Sundries—Press Clippings	16.16
19	Expenses—F. Eberhard Haynes for Dec.....	291.91
19	Travel Expenses—Richard H. Trent in S.F.	625.60
20	Cables for January—Honolulu.....	84.02
28	Travel Expense—A. W. T. Bottomley in S.F.	560.00
24	Travel Expense—R. H. Trent in S.F.....	340.00
24	Travel Expense—A. J. Wirtz in S.F.....	250.00
24	Sundries—postage	3.00
25	Sundries—Rental Monroe Calculating Machine	15.00
	Sundries—Stationery	10.05
26	Sundries—Express Charges	1.25
27	Travel Expense—R. H. Trent to Honolulu..	200.00
28	Cables for January—S.F.	158.68
28	Sundries—Binding 24 vols. of Star-Bulle- tin and Freight to S.F.....	46.00
Mar. 2	Travel Expense—Atherton Richards to S.F.	135.00
	Travel Expense—Geo. Sherman to S.F.....	350.00
5	Expenses—W. F. Frear.....	47.30
6	Travel Expense—W. F. Frear to Honolulu	175.00
	Expenses—F. C. Atherton.....	500.00
	Expenses—C. R. Hemenway.....	100.00
9	Travel Expense—A. J. Wirtz in S.F.....	125.00
10	Travel Expense—C. R. Hemenway in S.F..	742.22
12	Cables for February—Honolulu.....	28.25
12	Sundries—Newspapers to Sutro.....	5.60
13	Travel Expense—C. R. Hemenway in S.F..	330.37
13	Expenses—F. Eberhard Haynes for Jan....	632.89
13	Expenses—C. R. Hemenway.....	100.00
13	Travel Expense—F. C. Atherton to Honolulu	150.00
13	Travel Expense—F. C. Atherton.....	300.00
13	Travel Expense—F. C. Atherton—addi- tional charge on trip.....	25.00
31	Travel Expense—A. W. T. Bottomley in S.F.	620.00
21	Expense—C. R. Hemenway.....	200.00
21	Travel Expense—A. J. Wirtz in S.F.....	125.00
21	Sundries—Yosemite Taxicab Company.....	138.82
21	Sundries—Press Clippings	14.36
21	Expenses—Pillsbury, Madison & Sutro— Bill of March 6.....	2,204.36

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

23	Legal Fee—Holton, Richards & Co., Inc.....	5,000.00
23	Expenses—C. R. Hemenway.....	200.00
24	Cable	1.44
30	Travel Expense—Atherton Richards in S.F.	105.00
30	Cable—refund Alexander & Baldwin.....	25.00
31	Travel Expense—Mr. Stainback to S.F.....	125.00
Forward.....		\$ 20,660.26
1925	Forward.....	\$ 20,660.26
Mar. 31	Travel Expense—A. J. Wirtz in S.F.....	125.00
	Travel Expense—C. R. Hemenway in S.F....	100.00
Apr. 8	Cables—S.F.	37.62
	Sundries—Rent of calculating machine.....	15.00
	Travel Expense—Atherton Richards in S.F.	135.00
	Travel Expense—Atherton Richards to Honolulu	135.00
13	Fees—Atherton Richards	350.00
14	Sundries—Newspapers to Sutro.....	3.10
15	Expenses—C. R. Hemenway in S.F.....	200.00
	Expenses—C. R. Hemenway in S.F.....	100.00
	Expenses—C. R. Hemenway in S.F.....	358.53
	Sundries—Yosemite Taxicab Co.....	73.13
	Sundries—Press Cuttings	9.20
30	Travel Expense—A. W. T. Bottomley in S.F.	600.00
18	Expense—Pillsbury, Madison & Sutro— bill of April 3.....	1,905.46
18	Expense—C. R. Hemenway.....	250.00
18	Sundries—Rent of Calculating Machine.....	15.00
18	Expense—C. R. Hemenway.....	300.00
18	Travel Expense—A. J. Wirtz in S.F.....	125.00
18	Sundries—Postage	2.88
18	Sundries—Express	1.00
20	Cables for March—Honolulu.....	53.94
24	Travel Expense—Atherton Richards to S.F.	125.00
25	Cable	5.30
29	Fees—I. M. Stainback	1,000.00
29	Expenses—I. M. Stainback	245.00
May 4	Expenses—R. A. Cooke	1,250.00
8	Travel Expense—A. J. Wirtz in S.F.	125.00
	Expense—C. R. Hemenway.....	100.00
	Cables—S.F.	91.80

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

	Travel Expense—A. J. Wirtz in S.F.....	125.00
	Expense—I. M. Stainback.....	150.00
	Expense—C. R. Hemenway.....	100.00
	Cable to Judge Stanley.....	14.75
	Sundries—Taxi	1.00
11	Expenses—Pillsbury, Madison & Sutro.....	2,140.65
	Expenses—F. Eberhard Haynes for Feb. and March	1,585.69
	Travel Expense—A. J. Wirtz in S.F.....	125.00
14	Travel Expense—W. F. Dillingham— Steamer fares and expenses.....	1,000.00
18	Sundries—Yosemite Taxicab Co.	93.83
	Sundries—Press Clippings	9.88
	Sundries—3 copies of "Valuation of Industrial Securities	16.00
	Forward.....	\$ 33,859.02
1925	Forward.....	\$ 33,859.02
May 18	Travel Expense—C. R. Hemenway in S.F...	343.45
	Expense—C. R. Hemenway.....	200.00
	Travel Expense—Atherton Richards.....	105.00
	Cables—Honolulu	77.03
	Expense—C. R. Hemenway.....	250.00
22	Fees, etc.—W. F. Frear.....	3,031.80
27	Sundries—Garage Space in S.F.....	21.00
	Expense—Atherton Richards in S.F.....	105.00
	Expense—C. R. Hemenway.....	100.00
	Travel Expense—A. J. Wirtz.....	125.00
	Fees—Atherton Richards	1,500.00
	Fees—Holton, Richards & Co.....	3,500.00
	Sundries—Stationery	4.50
	Sundries—Comptometer & Operator 1½ days	15.00
	Cables for April—S.F.....	98.76
29	Expenses, etc.—Covington, Burling & Rub- lee Washington, D.C.	1,071.80
	Expenses—C. R. Hemenway.....	200.00
	Expenses—Atherton Richards	132.00
	Expenses—C. R. Hemenway.....	200.00
June 4	Sundries—Express Charges	2.00
10	Travel Expense—Advance to Old Colony Club a/c. W. H. Lawrence.....	373.12

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

10	Sundries—Rent of Typewriter.....	10.00
10	Sundries—Rent of Calculator.....	15.00
10	Expense—Pillsbury, Madison & Sutro— bill of May 24.....	2,290.95
10	Expense—Atherton Richards in S.F.	120.00
10	Travel Expense—A. J. Wirtz in S.F.....	125.00
10	Sundries—Stationery	4.70
12	Radios	31.55
15	Cables for May—Honolulu	99.63
16	Sundries—Newspapers to Sutro.....	2.95
15	Sundries—Garage Space S.F.....	15.00
	Travel Expense—C. R. Hemenway in S.F....	304.18
	Expense—C. R. Hemenway.....	250.00
	Sundries—Press Clippings	10.40
24	Expense—C. R. Hemenway.....	100.00
	Expense—Atherton Richards.....	111.00
	Travel Expense—A. J. Wirtz.....	125.00
	Expense—F. Eberhard Haynes Bill of May 30	795.05
	Expense—C. R. Hemenway.....	250.00
	Sundries—Yosemite Taxicab Service	51.08
	Sundries—Underwood Typewriter Co.....	3.50
	Expenses—Atherton Richards	147.50
Forward.....		\$ 50,176.97

1925	Forward.....	\$ 50,176.97
June 24	Expense—C. R. Hemenway.....	50.00
27	Expense—C. R. Hemenway.....	200.00
27	Travel Expense—Atherton Richards in S.F.	105.00
27	Travel Expense—A. J. Wirtz in S.F.....	125.00
27	Fees—F. Eberhard Haynes.....	7,000.00
27	Travel Expense—W. H. Lawrence to Washington and back.....	321.90
30	Fees, etc.—Smith, Warren, Stanley & Vitousek	5,079.99
	Travel Expense—A. W. T. Bottomley to Honolulu	200.00
July 7	Sundries—Underwood Typewriter Co.....	10.00
	Sundries—Office Supply Co.....	20.00
	Expense—C. R. Hemenway.....	200.00
	Expense—Pillsbury, Madison & Sutro— Bill of June 29.....	2,066.17

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

	Expense—C. R. Hemenway.....	100.00
	Expense—C. R. Hemenway.....	50.00
	Expense—Atherton Richards	111.00
	Travel Expense—A. J. Wirtz in S.F.....	125.00
	Fees—Atherton Richards	2,000.00
	Fees—Atherton Richards	4,000.00
13	Cables for May—S.F.....	79.30
17	Sundries—Garage Space S.F.....	15.00
	Sundries—Press Clippings	6.80
	Expense—C. R. Hemenway.....	200.00
	Sundries—Yosemite Taxicab Co.....	73.80
	Expense—C. R. Hemenway.....	50.82
	Expense—C. R. Hemenway.....	200.00
	Travel Expense—A. J. Wirtz.....	125.00
	Expense—Atherton Richards	120.00
20	Cables for June—Honolulu.....	98.83
22	Expense—Atherton Richards	105.00
	Travel Expense—A. J. Wirtz.....	125.00
	Sundries—Underwood Typewriter Co.....	10.00
	Sundries—1 copy Valuation of Industrial Securities	5.00
27	Expense—Atherton Richards	150.00
	Travel Expense—A. J. Wirtz.....	125.00
	Expense—Lunch for five.....	7.20
	Radio	1.50
	Travel Expense—C. R. Hemenway to Honolulu	400.00
Aug. 4	Sundries—Newspapers to Sutro.....	3.10
	Sundries—Sign painting of Exhibits— George W. Watson.....	46.14
	Sundries—Stationery	1.95
	Travel Expense—A. J. Wirtz.....	125.00
	Expense—Atherton Richards	138.00
Forward.....		\$ 74,153.47
1925	Forward.....	\$ 74,153.47
Aug. 7	Expense—C. R. Hemenway	\$ 70.00
	Expense—F. Eberhard Haynes—bills of July 21 and 22.....	2,196.93
11	Cables for June—S.F.....	16.10
14	Sundries—Press Clippings	10.36
	Sundries—Office Supply Co., Ltd. Honolulu	10.00

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

Aug.	Travel Expense—A. J. Wirtz to Honolulu..	115.00
	Sundries—Yosemite Taxicab Co.....	89.78
	Fees—W. H. Lawrence	5,000.00
	Fees—Atherton Richards	2,500.00
	Fees—C. R. Hemenway.....	10,000.00
17	Fees—Special audit of Insurance Dept. Records	400.00
22	Cables for July—Honolulu.....	19.08
26	Cables for July—S.F.....	50.29
31	Expense—Atherton Richards	210.00
31	Expense—Stenographic Service	30.00
31	Travel Expense—A. J. Wirtz.....	212.50
31	Expense—Pillsbury, Madison & Sutro— bill of Aug. 6.....	4,183.70
31	Travel Expense—Atherton Richards to Honolulu	130.00
31	Sundries—Stationery	1.25
Sept. 4	Fees—Price, Waterhouse & Co.....	17,757.91
8	Sundries—Typewriter Rental	2.50
	Sundries—Stationery	1.50
	Sundries—Office Supply Co. for calculator	10.00
10	Cables for August—Honolulu.....	16.35
17	Expense—C. R. Hemenway—insurance (refunded April 1926).....	10.00
21	Fees—Ford Bacon & Davis—Services of Chas. N. Black as expert witness.....	1,000.00
	Expenses—Ford, Bacon & Davis.....	204.10
	Sundries—Press Clippings	5.44
	Expenses—Pillsbury, Madison & Sutro— bill of Sept. 3.....	2,197.99
	Fees—Pillsbury, Madison & Sutro—paid to Edwin Evans Metzger	1,000.00
	Fees & Expenses—Atherton Richards.....	7,051.15
30	Cables for Aug.—S.F.	21.45
Oct. 6	Cables for Sept.—Honolulu	36.50
5	Sundries—Express Charges on documents..	1.93
7	Sundries—drayage on documents	1.00
7	Fees—George N. Keystone	500.00
	Expense—Pillsbury, Madison & Sutro— bill of Sept. 29.....	1,085.96
	Sundries—Freight on documents.....	1.97
16	Fees—Peat, Marwick Mitchell & Co.....	4,500.00
	Fees & Expenses—Covington, Burling & Rublee	1,249.34
	Fees—W. H. Lawrence	5,000.00

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

23	Sundries—Crating documents—8 packing cases	20.00
	Forward.....	\$141,073.55
1925	Forward.....	\$141,073.55
Oct. 31	Sundries—Expressage on documents	91.40
31	Fees—W. H. Lawrence	20,000.00
31	Fees & Expenses—F. Eberhard Haynes.....	19,512.02
31	Sundries—Expressage	2.40
Nov. 7	Sundries—Packing Box .....	.50
16	Fees—Hughes, Rounds, Schurman & Dwight	15,000.00
16	Expenses—Hughes, Rounds, Schurman & Dwight	343.69
	Expenses—Pillsbury, Madison & Sutro.....	78.95
17	Cables for Sept.—S.F.	5.00
Dec. 11	Fees—Real Estate Valuation— Henry Waterhouse Trust.....	500.00
14	Cables—refund to Pillsbury, Madison & Sutro	3.68
29	Fees—Royal D. Mead.....	1,500.00
30	Sundries—Expressage	3.13
	Total Expenses 1925.....	\$198,114.32
1926		
Jan. 19	Fee—Oscar Sutro—Balance of fee.....	\$100,000.00
Feb. 6	Expense—Pillsbury, Madison & Sutro— Expense of witnesses 12/15/24 to 8/15/25	1,250.00
23	Cables for January—S.F.	32.06
26	Expense—Pillsbury, Madison & Sutro— bill of Feb. 4.....	127.20
Mar. 23	Oscar Sutro—Fees	50,000.00
	Fees—R. H. Trent	5,000.00
Feb. 26	Fees—Pillsbury, Madison & Sutro— refund of Retainer Fee.....	*7,500.00
Apr. 24	Expense—C. R. Hemenway Insurance Refunded paid Sept. 17, 1925.....	*10.00

* Figures in red.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

5	Expense—Pillsbury, Madison & Sutro— bill of March 25.....	44.00
23	Cables for March—S.F.....	38.95
27	Cables—Honolulu	2.90
July 10	Expenses—Pillsbury, Madison & Sutro.....	9.00
24	Expenses—Pillsbury, Madison & Sutro.....	2.66
Aug. 20	Expenses—Pillsbury, Madison & Sutro.....	110.92
Sept. 28	Expenses—Pillsbury, Madison & Sutro.....	5.50
Oct. 13	Expenses—Pillsbury, Madison & Sutro.....	4.11
Total Expenses 1926.....		<u>\$149,117.30</u>

1927

Feb. 28	Cables—S.F.	\$ 2.00
Mar. 10	Cables—Honolulu	46.25
17	Cables—S.F.	119.05
Apr. 14	Cables—Honolulu	14.20
19	Expenses—Pillsbury, Madison & Sutro— bill of April 7.....	1,825.02
19	Sundries—Press Clippings	3.68
21	Sundries—Notary Fee	4.00
22	Cables for March—S.F.....	14.80
30	Fees—W. H. Lawrence	2,000.00
May 14	Sundries—Press Clippings	3.00
16	Fees—Smith, Warren, Stanley & Vitousek..	252.25
26	Expenses—Pillsbury, Madison & Sutro.....	209.99
31	Fees—F. Eberhard Haynes.....	1,738.30
June 22	Expenses—Pillsbury, Madison & Sutro.....	10.45
July 20	Expenses—Pillsbury, Madison & Sutro.....	4.50
	Cables—Message to A. W. T. Bottomley.....	8.00
Total Expenses 1927.....		<u>\$ 6,255.49</u>

1928

Mar. 20	Sundries—Express Charges	\$ 4.38
31	Expense—Pillsbury, Madison & Sutro.....	5.40
Dec. 24	Expense—Pillsbury, Madison & Sutro.....	2.49
Total Expenses 1928.....		<u>\$ 12.27</u>

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

1929

Oct. 26	Fees—Oscar Sutro	\$ 10,000.00
Dec. 23	Sundries—Expressage on Books.....	1.75
24	Fees—Smith, Warren, Stanley & Vitousek (<i>cancelled Feb. 1930</i>).....	2,539.28
31	Expense—Pernau Welsh Printing Co.....	3,311.80
Total Expenses 1929.....		<u>\$ 15,852.83</u>

1930

Feb. 28	Fee—Smith, Warren, Stanley & Vitousek— charged in error (Dec. 24, 1929)	\$ *2,539.28
May 13	Cable	10.80
21	Expense—Pillsbury, Madison & Sutro— bill of May 3.....	8.70
Aug. 11	Cable	5.70
Sept. 8	Cable	10.56
24	Expense—Pillsbury, Madison & Sutro— bill to Sept. 5.....	50.14
Oct. 28	Expense—Pillsbury, Madison & Sutro— bill to Oct. - 8.....	697.95
Nov. 14	Cable—Honolulu	5.00
21	Expense—Pillsbury, Madison & Sutro— bill to Nov. 6.....	21.15
22	Expense—Pillsbury, Madison & Sutro— bill to Nov. 13.....	22.00
Total Expenses 1930.....		<u>\$ *1,707.28</u>

* Figures in red.

1931

Jan. 20	Expense—Pillsbury, Madison & Sutro— bill of Dec. 10.....	\$ 68.45
June 25	Expense—Pillsbury, Madison & Sutro— bill of June 15.....	196.90
July 23	Expense—Pillsbury, Madison & Sutro— bill of July 10.....	63.01
Aug. 20	Expense—Pillsbury, Madison & Sutro.....	10.75
28	Fees—F. Eberhard Haynes—bill of Aug. 15	3,837.29

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-7—(Continued)

Sept. 4	Cables S.F.	31.43
Oct. 20	Expense—Pillsbury, Madison & Sutro.....	150.12
Nov. 20	Expense—Pillsbury, Madison & Sutro.....	135.25
Dec. 24	Expense—Pillsbury, Madison & Sutro.....	26.48
Total Expenses 1931.....		<u>\$ 4,519.68</u>

1932

Jan. 21	Expense—Pillsbury, Madison & Sutro.....	\$ 8.18
Feb. 25	Expense—Pillsbury, Madison & Sutro.....	5.42
Mar. 17	Expense—Pillsbury, Madison & Sutro.....	7.60
Apr. 21	Expense—Pillsbury, Madison & Sutro.....	5.52
May 10	Expense—Pillsbury, Madison & Sutro.....	53.85
June 22	Fees—F. Eberhard Haynes.....	2,826.39
30	Expenses—Pillsbury, Madison & Sutro.....	15.74
July 21	Expenses—Pillsbury, Madison & Sutro.....	23.60
28	Fee—Oscar Sutro—final fee including that due associates.....	85,000.00
30	Sundries—expressage on exhibits.....	1.15
Aug. 23	Expense—Pillsbury, Madison & Sutro.....	26.69
Sept. 22	Expense—Pillsbury, Madison & Sutro.....	5.06
Oct. 6	Cable	13.30
Total Expenses 1932.....		<u>87,992.50</u>

Recapitulation

Total Expenses 1924.....	\$108,450.65
Total Expenses 1925.....	198,114.32
Total Expenses 1926.....	149,117.30
Total Expenses 1927.....	6,225.49
Total Expenses 1928.....	12.27
Total Expenses 1929.....	15,852.83
Total Expenses 1930.....	*1,707.28
Total Expenses 1931.....	4,519.68
Total Expenses 1932.....	87,992.50
Grand Total.....	<u>\$568,607.76</u>

* Figures in red.

(Testimony of Sherwood M. Lowrey.)

Q. (By Mr. Wild): Mr. Lowrey, Mr. Cades suggested to me that you hadn't made a full answer to my question as to what discussion there was between American Factors and the group that signed Exhibit 1 annexed to P-5 concerning who would ultimately bear the cost of litigation at the time this organization was set up. [102]

A. For the time being——

Mr. Atherton: Your Honor, I have to object. There is no foundation for that question. The witness has been interrogated with respect to the agreement between the co-defendants other than American Factors, and now he is trying to enlarge without foundation therefor to bring the American Factors into the picture.

Mr. Wild: Well, I am just asking him if there was any discussion.

The Court: Read the last question.

(The reporter read the last question.)

The Court: Well, that is short-cutting quite a bit. Just how is this witness in a position to know?

Mr. Wild: Well, I might ask him that.

Q. As treasurer of American Factors, Limited, was it your duty at that time to have supervision over contracts and agreements between Factors and others? A. It was.

Q. And as a part of that duty, did you make any inquiries concerning what, if any, share of the expense American Factors was to pay at that time on its own account?

(Testimony of Sherwood M. Lowrey.)

A. There was discussion at that time to the effect that, not knowing how the whole thing was going to come out, not knowing when it would be settled, that the question was finally——[103]

Mr. Atherton: His answer goes beyond the question, and the answer must be Yes or No.

The Court: Well, that is true. Ultimately, though, to get anything out of this you will probably have to go into the matter we are dealing with now. The objection is sustained.

Q. Well, did you answer the question that there was some discussion? A. Yes.

Q. What was that discussion?

The Court: Let's have it a little more definite, the discussion. I can't tell whether it was on the street, in a restaurant or with whom it was. It may have been in the back rooms of the merchandising department. If you are going into some discussion, tell where it was. I'd like to have it particularized a little bit, what kind of a discussion you are talking about.

Q. (By Mr. Wild): You said there was a discussion. About what time was that discussion had?

A. That discussion was had about the time that this agreement was that we made reference to was signed.

Q. Where?

A. For the simple reason that I, as treasurer of the company, I had to have my instructions to know what to do. [104]

(Testimony of Sherwood M. Lowrey.)

Q. And where was this discussion concerning Hackfeld litigation expenses, where did it take place?

A. As I remember, it was either in Mr. Bottomley's office or my office, which was adjacent to his, Mr. Bottomley being the president and manager of the concern.

The Court: Who was carrying on this discussion? I'd like to find out something about the nature, the bonafideness of the discussion and materiality of it. Where does it come in?

Q. (By Mr. Wild): Who were present at the time?

A. Well, in the early stages there there were several present, in the formation of this committee who was going to be the steering committee, as I remember it, most of the time there were the four men present.

The Court: You remember that now from your own personal, direct knowledge, or do you remember it from what you gathered from hearsay here and there? Is it just an impression that you carry or is it based upon some actual absolute knowledge of your own?

The Witness: Knowledge of my own. If I may go into that with you for a minute, I remember very distinctly night after night working on cablegrams that had to be coded. I did them myself.

The Court: I know, but at whose instance, whose cables? [105]

(Testimony of Sherwood M. Lowrey.)

The Witness: That would be the instance of Mr. Oscar Sutró, who was head counsel for the firm, and he in conference with Mr. Bottomley, Cooke and Atherton and Hemenway discussed things in Bottomley's office. Most of the time the door was open. I could hear a large part of those discussions. They would then take out and bring on the long coded messages that had to be sent to the mainland. And Mr. Wirtz, who is now gone, he and I would spend night after night making up these messages. In the morning we'd take these messages or within a day or so they'd be back from the mainland, and we'd have to decode these messages. And I had a very intimate touch with the whole situation.

The Court: That answers very clearly as to the part taken by officers of the American Factors in the litigation, in the course of the litigation, in the management perhaps of the litigation, but it doesn't come back to the question that counsel had in mind as to the relations between this hui—that they were going to put up the money—relations between this hui and American Factors, the corporation, as to any ultimate division or repayment or anything of that sort concerning this cost of litigation.

The Witness: I can explain the instructions that were given to me.

The Court: By whom?

The Witness: Mr. Bottomley. [106]

The Court: Mr. Bottomley was the president of the company?

(Testimony of Sherwood M. Lowrey.)

The Witness: Of the concern.

The Court: Well, I don't want to carry on the examination, but that would seem to be pertinent.

Q. (By Mr. Wild): What were those instructions, Mr. Lowrey?

A. That for the time being I was to keep an absolute track of all the expenses paid out in connection with the Hackfeld litigation; that this group, in accordance with their agreement, were from time to time to be billed as would be agreed upon, an amount to cover each one prorata of the amount of expenses that then stood unpaid for; that the account was to be carried on in that manner and that eventually it would be decided, if the suit had been determined, as to where the ultimate expense of the thing to be borne, as to who would ultimately bear the expense.

The Court: That is Bottomley?

The Witness: Yes.

Q. And those were instructions long prior to the trial of the suit?

A. I forget just when the trial of the suit started. It was all along the line when this group signed this agreement, that that was the way it would be handled.

Q. And it was part of your duties as treasurer of [107] American Factors? You then carried this account, the itemization of which is shown in P-7 on an account in the American Factors books?

A. Yes.

(Testimony of Sherwood M. Lowrey.)

Q. Now, examining that account in the American Factors books——

A. I haven't got a copy of that, unless it is that copy there, if I may use that one.

(The Clerk hands a document to the witness.)

Q. I have asked you to check in this segregation of accounts the various items that were known about in each year. Calling your attention specially to the items——

The Court: Has opposing counsel got a copy of that?

The Witness: I have furnished, as that letter shows on the exhibit, I furnished the Government with altogether eight copies of this thing, your Honor. Mr. Peterson had copies. As this letter shows, we sent two on to them.

Mr. Atherton: Don't you have a copy that you can loan me?

Mr. Wild: Well, this is the last. As I told you when I conferred with you, you have got me down to where I only had one copy left. The Government is about eight to one. Here, maybe we can look at it together. I don't want——

The Court: Well, it is very interesting reading. What is it you want to draw from it? [108]

Mr. Wild: Well, he wanted to see this. I have directed his attention to the items in the year 1932 in that account.

Q. What have you to say as to whether or not

(Testimony of Sherwood M. Lowrey.)

any of the amounts of any of those charges had been fixed prior to the year 1932?

A. Not to the best of my recollection.

Q. Have you looked that matter up? You have looked that matter up, had you not?

A. And, as I remember it, nothing was definitely fixed because they didn't know how long the case was going on or how much of the service would be required.

Q. I see. So that these items that appear for 1932, at the beginning of the year 1932, the amounts, none of them had become definite?

A. Not that I know of.

The Court: Those consist of attorney fees?

Mr. Wild: Yes, your Honor. Some, your Honor will see at the end here, were paid in July of that year, fifty-eight thousand, the final attorney fees, you see.

The Court: What were some frequent payments made to Charles Hemenway? Was he one of the attorneys?

Mr. Wild: I will ask the witness about that.

The Witness: It was felt very necessary in the early part of the stages there to have Mr. Hemenway, who was employed by another concern, to go to the mainland to follow [109] through and see about getting the proper attorneys to handle the defense of this action. And it was felt at that time that Mr. Hemenway should not be asked to do this without compensation. Therefore, arrangements

(Testimony of Sherwood M. Lowrey.)

were made with Mr. Hemenway to take, and in addition to paying the expenses of himself and wife, as the account shows, to take and pay him certain compensation for services.

Q. Was Mr. Hemenway an attorney admitted to practice before the court that you know at that time? A. Yes, he was.

Q. And at that time he was an official of Alexander and Baldwin?

A. I think so. I don't know just to date that, just the date that he severed his law connections and entered A and B. I don't remember.

Q. And the services that he performed were to confer over the facts of this case and bring them to the attention of counsel acting for the defendants, was that it?

A. Yes, on account of his full knowledge of the formation of American Factors, with his legal training it was felt wise to have him up there to confer with the attorneys who were going to represent the defendants in this suit.

Q. Now, as to the principal items that are shown on Exhibit P-7, have you made a statement as to whether or not this so-called steering committee approved those prior to [110] payment?

A. The large items, yes. The small items, it was left up to me. If it was an expense incurred in connection with the litigation, it was perfectly proper for me to take and have those charged

(Testimony of Sherwood M. Lowrey.)

against the litigation expense.- They delegated that power to me.

Q. Now, there was reference made in Exhibit 2 annexed to P-5 to some litigation in New York. Was any part of the expense listed and itemized in P-7 the expense in connection with that litigation in New York referred to?

A. No, that was kept separate under a separate litigation expense account. I remember correctly, it was the Isenberg-Swartz litigation.

Q. But it has nothing to do with the Hackfeld litigation? A. No, it has not.

The Court: Well, there is one reference to it. What was the nature of that litigation? Didn't that involve, the expense of that——

Mr. Wild: No, none of it here—he just testified that there isn't an item of this expense that we claim that was on account of that litigation.

The Court: Where is it mentioned here as to it?

Mr. Wild: New York litigation.

The Court: Yes. [111]

Mr. Wild: In the resolution, which is Exhibit 2 annexed to P-5. You remember, your Honor?

The Court: Yes.

Mr. Wild: And I was showing the fact as to whether or not any of the litigation expense appearing in P-7 was in connection with that suit. And the witness has checked and said No, it has nothing to do with it.

The Court: Yes.

(Testimony of Sherwood M. Lowrey.)

Q. (By Mr. Wild): At the request of counsel have you prepared a copy of the book entries as they appear under Hackfeld litigation expenses showing the reimbursements?

A. Yes, I had that prepared.

Q. And I think I furnished a copy to counsel for the Government.

A. I have a copy here.

Q. This two-sheet one which we furnished at your request. And I told you that I'd put it on. I will ask you what this statement shows, Mr. Lowrey?

A. It shows first the charges in a lump sum, the details of which are already shown in detail in P-7.

Q. Yes.

A. Then it shows the credits setting forth the various amounts that were credited to that account; the principal portion of which, rather the vast majority of it is the payments [112] that were made by the defendants named in the suit, with a few other minor credits that came in in the way of adjustments.

Q. How was that account finally disposed of in the books? Is that shown there? A. Yes.

Q. Do you have a copy of it, another copy?

A. The Judge has it.

Q. Is that the original?

A. That is the original.

Mr. Wild: May we offer the original in evidence?

(Testimony of Sherwood M. Lowrey.)

Mr. Atherton: May I ask you, Mr. Wild, are the books here?

Mr. Wild: No. We will be very pleased to get them.

Mr. Atherton: Do you propose to have the witness testify just how this is treated on the books, what account it is charged to, and so on?

Mr. Wild: I would ask him to, yes. I didn't understand that counsel wanted the books here. We told him that they are available, and the revenue office, as your Honor knows, sends a man down and checks everything. And I was going to ask him about these. As a matter of fact, I am doing this because I promised Government counsel I'd bring it out.

Mr. Atherton: Well, I merely wanted to be sure that you are not just going to stop when you offer this statement. [113] I want more information about the statement in the record.

Mr. Wild: And you'd be privileged naturally to ask any question on cross.

Mr. Atherton: Lay the foundation for it by developing how it was all charged, and so forth. You see, it is not informative, your Honor, as it stands. It is headed "Hackfeld Litigation" and debits and credits, and doesn't show what account it was charged to, whether it is an expense account, profit or loss account, reserve account, or what have you, so I want the record to show that as a pre-

(Testimony of Sherwood M. Lowrey.)

requisite to the admissibility of this statement in evidence.

Mr. Wild: This is, as I understand it—he testified to it as an abstract of an account in the American Factors’ ledger known as the Hackfeld litigation.

The Court: I think that the objection, the insistence that it isn’t the best evidence, must be sustained.

Mr. Wild: Well, I asked him, your Honor, if he wanted the books and he said No.

The Court: Well, now he apparently says he does.

Mr. Wild: Do you want the books?

Mr. Atherton: Well, I feel this way, your Honor: I don’t want to cause the taxpayer any inconvenience.

Mr. Wild: No inconvenience about it. We would have them up here.

Mr. Atherton: Have the record show now, explain more [114] in detail what this account is on the books, how it was set up, and if that is satisfactory then we won’t need the books. But just submitting a statement saying “account of the books” doesn’t convey any information at all.

The Witness: I can explain that.

Q. (By Mr. Wild): Very well. May I ask you about this account? A. May I have that?

Q. Explain it, how it is set up on the books and what books it was from?

(Testimony of Sherwood M. Lowrey.)

A. We set up in the general ledger of American Factors, Limited, an account entitled "Hackfeld Litigation." Against that account we charged all payments made in connection with litigation expenses. We credited against that account any amount of money that came in, such as the payments made by these 22 respondents, and anything else that may have gotten charged, we will say, to the error, as I notice in here. There's one or two little ones, a refund of a ticket that had been charged in error; so that all the outgo and all the income during that whole period of years was carried under the one account, Hackfeld litigation. At the end——

Mr. Atherton: Excuse me a minute. May I ask a question to clarify it?

Mr. Wild: Oh, yes.

Mr. Atherton: Was that a memorandum account? [115]

The Witness: No, in the general ledger.

Q. (By Mr. Atherton): I don't want to argue, but will you say that you carry in your ledger, general ledger accounts, memorandum accounts?

A. I believe there is one memorandum. If you and I mean the same thing now by memorandum account. I believe there is one thing in there that has certain things to do about possibly invested capital that has been written off the books, which is kept in there as a memorandum only in order that it can be used for tax purposes, like organiza-

(Testimony of Sherwood M. Lowrey.)

tion expense. That was all written off. And still it is part of the invested capital. I think there is such an account there.

Q. Well, how do you close out this account, this so-called account?

A. All right. This account was kept open until such time as the determination had been made as to who was to bear the final cost. At that time, it was in 1932, there was a balance in the general reserve account which was carried over from Hackfeld and Company that had a credit to it of \$541,237.79. That amount of litigation expense was charged against that reserve to wipe it out. That was the reserve, you will note, that has been from statements made in this Courtroom here, was the reserve created to cover any undisclosed liabilities of Hackfeld and Company. We then needed [116] \$27,369.97 to wipe out and make up the balance of the cost of the litigation, which was \$568,000 odd. That twenty-seven thousand was charged against earned surplus.

The Court: Against what?

The Witness: Earned surplus.

The Court: That is earnings of a corporation, of American Factors?

The Witness: Yes.

The Court: Set up a surplus account from the end of the first year?

The Witness: Yes, what some corporations call their undivided profit account; we call it the earned surplus account.

(Testimony of Sherwood M. Lowrey.)

The Court: Well, the Factors had begun to set up such an account towards the end of their first year of operation?

The Witness: Yes, sir. In other words, the profits for the year which were not paid out in dividends went to the earned surplus account, and each year thereto the profits not paid out were added to the earned surplus account, and each year thereto the profits not paid out were added to the earned surplus account.

The Court: So after wiping out the Hackfeld surplus account you went into your own to the extent of twenty-seven thousand?

The Witness: Twenty-seven thousand dollars, yes, sir.

Q. (By Mr. Wild): But all of the assets offset against that reserve [117] in the Hackfeld litigation account belonged to American Factors, didn't they?

A. Yes. That was the balance between the value, the net value of the assets; in other words, the gross value of the assets less the outstanding liabilities was a certain figure; your capital stock which was paid for was seven and one-half million; the difference between the net value of your assets and the seven and one-half million was this reserve which, as I remember it, was around seven hundred thousand dollars. But prior to 1932 there had been certain undisclosed liabilities showed up which had been settled and charged against that reserve which had

(Testimony of Sherwood M. Lowrey.)

reduced it then down to whatever this balance figure was, 570,000. That is as I remember it.

Mr. Wild: We would offer this statement in evidence and ask that it be marked as P-8.

The Court: Did you keep any ledger account with these different individuals here?

The Witness: No, did not, sir.

The Court: So these were all cash transactions?

The Witness: Yes, sir. In other words, I'd figure it out this way, that when, we will say, \$75,000 of expenses had incurred, and there were \$25,000 of shares involved in this, ownership by these people, I'd go to Mr. Bottomley and say, I think we had better get some money in on this. How [118] much do they owe us? Well, we have advanced \$75,000. I'd suggest that we levy an assessment, if you want to call that, or ask them to contribute at the rate of three dollars per share; three dollars per share times the 25,000 outstanding shares would bring the \$75,000 in.

The Court: Well, this debt, this is what you had expended?

The Witness: Yes, sir, during the year.

The Court: And you made collections from these different persons who belonged to the hui?

The Witness: Yes, sir.

The Court: Now, at the end, what did you collect from Sherman?

The Witness: Because they paid, and you will note these collections came in late in December of

(Testimony of Sherwood M. Lowrey.)

1925. These four gentlemen or three gentlemen, Sherman, Bottomley and Welch and Company paid in the first few days of January. In other words, these remittances——

The Court: Pillsbury?

The Witness: Pillsbury—it should be Madison and Sutro. They sent in 75. There had been an overpayment to them on their account of seventy-five hundred dollars.

Mr. Wild: Your Honor, I think this is a noteworthy occasion and if the hour of four is a proper hour to adjourn, I think it calls for a celebration.

The Court: Well, this now is offered in evidence without any objection?

Mr. Atherton: Yes, your Honor, but I'd like to ask him some questions.

The Court: Before it is received?

Q. (By Mr. Atherton): Will you tell me whether or not Mr. Bottomley directed you to carry these litigation expenses in a suspense account?

A. Yes. In talking it over, whether he told me to do it or I suggested to him that that would be the proper way that it was done, I don't know. But that was the way that it was done. You see, we are going back here now to 1924.

Q. Would you say that these entries here on this exhibit really reflect more or less adjustment entries, adjustment entries, just bookkeeping adjustments?

A. I don't know the term "adjustment entries."

(Testimony of Sherwood M. Lowrey.)

Q. Well, to adjust.

A. These are actual entries. These are copies of actual entries in the books.

Q. Were they not entered on the book to give effect to past transactions?

A. No, because they are entered on the book as the payments were either made or the receipts came in. Most of [120] those entries would naturally, a large portion would go right straight through the cash books.

Q. By payment made, what do you mean by that statement? Payment made by whom?

A. Well, payment made by American Factors on behalf of the group. Take your first one, if you wish.

Q. That's all right.

Mr. Wild: Let him finish it.

A. The first one, Mr. Wirtz, working at night, a heavysset man, no means of communication, probably midnight or after that, hired an automobile to go home; reimbursement to him; travel expenses, Mr. and Mrs. Hemenway to San Francisco.

Q. I am talking about this last exhibit.

A. You are talking about receipts? I thought you were talking about payments. I am looking at the payments.

Q. This is a summary of the payments, is that right?

A. That is a summary of the account which is

(Testimony of Sherwood M. Lowrey.)

the receipts or the payments made by the individuals to American Factors.

Q. I see.

Mr. Wild: May that be marked "P-A" for identification so that that record will be clear on it?

The Court: Well, what I am wondering about is, there is an account of the Hackfeld litigation, but this isn't an account. Where did you keep those other accounts that [121] make up the P-7? Why aren't they all in the same account if it is an account of the litigation?

The Witness: They were—it was for this reason: The Internal Revenue Bureau had asked for the list of the expenses. That had already been submitted. And in order to get a complete—the other day when I knew I was going to be a witness here, I requested them to make up a memorandum of the receipts. The two could be combined very easily, if it would be of assistance.

The Court: And they are in the books?

The Witness: They are taken right from the books of the company.

The Court: So that these items would flow all the way through that in order to make up the 108 or 9 that you start with there?

The Witness: Yes, sir.

The Court: Well, I don't know that there is so much quarrel about the detail of these accounts. The main thing is as to the applicability under the law of the account.

(Testimony of Sherwood M. Lowrey.)

Mr. Wild: Yes.

Mr. Atherton: Well, what I am trying to establish, your Honor, is whether this was charged to profit and loss or to the general reserve.

Q. (By Mr. Atherton): As I take it, you have testified that this was [122] charged to a general reserve, and the balance to and under surplus account, and no part of it was charged to profit and loss?

A. No, sir.

Q. Never into profit and loss? A. No, sir.

Q. And when they closed out the account, they closed through surplus, isn't that correct?

A. Closed to that general reserve which was the so-called balance of the Hackfeld reserve and used all that, used all that up. The balance that was then still outstanding on this, to clear this Hackfeld litigation account, was charged to surplus or to earned surplus. And thereby the Hackfeld litigation account was wiped off the books, the Hackfeld reserve was wiped off and your earned surplus had been reduced by 27,000.

Q. You have stated, I believe for the record, how this other reserve was created as an excess of the value of the assets over the liabilities of the old Hackfeld Company, is that right?

A. That is right, as I remember it. I was not treasurer of the company at that time. In fact, when it was formed in 1918 I was not with the company. But that is my recollection. And then it must be also borne in mind that during the first

(Testimony of Sherwood M. Lowrey.)

seven months of 1918 Hackfeld was a going concern and presumably [123] had made some profit. And they had to set the thing up in their books as of the closing date. So it was the difference between the assets and the liabilities. And if I remember it, possibly the bureau, the men from the bureau behind you could tell you: But I think it was somewhere around seven hundred thousand. But I don't know. It could be ascertained.

Mr. Wild: If it is important, we will have the exact dollars tomorrow, your Honor.

The Court: You mean that after this hui that organized the plan to take over Hackfeld they took it over and operated it as Hackfeld and Company before the formation and organization of the American Factors?

The Witness: No, sir.

The Court: There was a time in there after Hackfeld——

The Witness: One moment. That Hackfeld and Company ceased to operate and the title passed to American Factors.

The Court: Immediately?

The Witness: Yes, right there. It had to be done. You couldn't operate under the two companies. Title either had to be in Hackfeld and Company or it had to be in American Factors. And at that time there was about seven hundred thousand dollars more assets than the capital stock. And,

(Testimony of Sherwood M. Lowrey.)

as shown later, there were undisclosed liabilities of Hackfeld that had to be taken care of. [124]

Mr. Wild: May I ask these questions?

Q. (By Mr. Wild): At the precise time, to wit, July 20, 1918, that the assets and businesses of H. Hackfeld and Company, Limited, were conveyed to American Factors, at that precise time the assets of H. Hackfeld and Company were evaluated per books, and the liabilities were determined per books, the excess of liabilities or the excess of assets over liabilities was something like \$700,000?

A. No.

Q. Well, will you explain it?

A. It was more than that. It was greater. It was more than seven and one-half million. Wait a second. Maybe I misunderstood you.

Q. The assets exceeded the liabilities, including the capital stock?

A. Oh, if you include the capital stock, by somewhere around \$700,000, as I remember it.

The Court: Seven what?

The Witness: Seven and one-half million.

The Court: That was Hackfeld capital stock?

The Witness: That was what American Factors paid Hackfeld and Company for their going business.

Mr. Wild: You see, actually on the books the net value of assets of H. Hackfeld and Company at that time was about [125] \$8,200,000 odd. American Factors paid \$700,000 for those assets. They set up

(Testimony of Sherwood M. Lowrey.)

capital, seven hundred thousand; capital, seven million and one-half, surplus seven hundred thousand; to make up the difference between the value of assets and the capital, then isn't that what was done?

The Witness: As I remember it.

The Court: Capitalized for five million?

The Witness: Five million, correct. But the stock was sold at \$150 per share. Therefore, the actual account was five million capital, two and one-half million paid in surplus, and then this seven hundred thousand in addition thereto.

Mr. Atherton: Your Honor, I think I could probably clarify this better after, tomorrow, after they bring in the books, to show how that account was originated in the books.

The Court: All right, you offered to do that.

Mr. Wild: May I ask a question? At present, Mr. Lowrey being retired, is not an officer of American Factors. He therefore does not have the custody of the books. Will you make any objection on the ground that they should be presented and identified by a proper officer of American Factors?

Mr. Atherton: No.

Mr. Wild: Because if you do, I will bring up the treasurer or secretary and he will bring them. So that if Mr. Lowrey brings them up, you won't make any objection? [126]

Mr. Atherton: No.

Mr. Wild: May I ask another question? About

(Testimony of Sherwood M. Lowrey.)

how long do you think you will be with Mr. Lowrey on cross-examination?

Mr. Atherton: Well, I can't tell. I want to think it over tonight as to some of the questions I might want to ask him. It might be 15 or 20 minutes more.

Mr. Wild: I mean, it would run a half hour——

Mr. Atherton: I may not ask him any questions after the books clarify themselves. But I can't tell. I want to deliberate on it.

Mr. Wild: Very well. Could I find out tomorrow? The only reason I am asking is because I don't want to keep any other witness,—I haven't any on this end of the case—I don't want to keep any other witness hanging around here unless we have to. That's all. I think I will be through with Mr. Lowrey in probably half or three-quarters of an hour more.

Mr. Atherton: I think so, too.

The Court: Well, I was going to ask you, you prefer to start at ten o'clock?

Mr. Wild: I do, your Honor.

Mr. Atherton: That is agreeable to me, your Honor.

Mr. Wild: It gives us a chance to call these other fellows:

The Court: It gives the Court a chance to run some other [127] business along.

Mr. Atherton: Are we going to have an afternoon session tomorrow?

(Testimony of Sherwood M. Lowrey.)

The Court: It looks as if we will have to.

Mr. Atherton: I'm anxious to get the case over.

The Court: So am I. I've got all next week tied up with criminal jury trials and I don't want to interfere with that if I can possibly help it. These two books here, you have submitted them to me but you also submitted a memorandum pointing out what you wanted to refer to here, so they haven't been put in evidence.

Mr. Wild: Oh, no, your Honor. I just brought them up. I thought your Honor might want to read them. But I've got to digest them.

The Court: I will pass them to the clerk to just hold them as custodian.

Mr. Wild: I thought your Honor might just like to go over them, the originals, but I have given copies to your Honor. Now, on this exhibit P-8, has that been received in evidence as yet?

The Court: No, because if we are going to get the books here, and they have been asked for and they will be brought in the morning, why, I don't want to settle the book account by putting these in now.

Mr. Wild: Well, your Honor, might I say this: The [128] Government asked for the item of expenses which was selected from this account. Now, the other side, the reimbursements to the account, you see, wasn't asked for. So they weren't in there.

The Court: I understand.

Mr. Wild: So that these two accounts together make up what the books show.

(Testimony of Sherwood M. Lowrey.)

The Court: You understood and meant to furnish everything that you thought was needed. But now the question arises in opposing counsel's mind as to just what this set-up was on the books and he wants to see the books, and that, of course, is the best evidence. So if you will bring those in tomorrow, we will have it. This case is continued until tomorrow morning at 10 o'clock.

(The Court adjourned at 4:15 p.m.) [129]

November 13, 1947

(The Court convened at 10:00 a.m.)

The Clerk: Civil No. 419, American Factors, Limited, versus Fred H. Kanne, Collector of Internal Revenue; case called for further hearing.

Mr. Wild: Ready to proceed for the Plaintiff. Mr. Lowrey was on the stand. I would ask that he be temporarily withdrawn so that another witness may take the stand briefly to prove ledger statements.

HAROLD C. EICHELBERGER

a witness in behalf of the Plaintiff, being duly sworn, testified as follows:

Direct Examination

By Mr. Wild:

Q. Will you state your name, Mr. Eichelberger?

A. Harold C. Eichelberger.

Q. And where are you a resident?

(Testimony of Harold C. Eichelberger.)

A. In the Territory of Hawaii. My home is in Kailua.

Q. That is on the Island of Oahu?

A. Island of Oahu.

Q. What is your present position with American Factors, Limited?

A. I am assistant treasurer and assistant secretary [130] of the company.

Q. As such officer of the company, you have under your custody and control the books of accounts of the company? A. I do.

Q. Have you produced here two accounts at my request? A. Yes, I have.

Q. And what are those accounts?

A. I have here the ledger sheets containing the record of the Hackfeld litigation expense account and of the general reserve account.

Q. And those are the sheets that you have there presently? A. That's right.

Q. And what are they numbered?

A. Each card of the ledger is given a number one as it started out each year, and, for instance, the first ledger card of the Hackfeld Litigation expense account is numbered one, started in 1924, continued on the back 1-A, and continued to a second card No. 2, and in which the balance then on the second card is the balance at the end of the year, and carried forward to the next year, card numbered one beginning January 1, 1925.

Q. Very well. And so on through?

(Testimony of Harold C. Eichelberger.)

A. Yes, and so on through.

Mr. Wild: I don't want to offer these in evidence, may [131] it please the Court. May I have them just marked for identification now as P——

The Court: Well, perhaps if you offer them for examination and may be able to substitute——

Mr. Wild: Exhibits for them?

The Court: Yes.

Mr. Wild: Yes, your Honor. That's what I wanted to do, because we had them merely today, as I understood, for check. May I withdraw this witness now, leaving the sheets here in the custody of the Court at present, and put Mr. Lowrey back on the stand?

The Court: Yes. I assume that is satisfactory.

Mr. Atherton: Before you do, I just wanted to ask the witness a question. I think he testified, your Honor, that he has ledger cards with respect to the reserve they are talking about to which these Hackfeld litigation expenses were charged. Was there no book of original entry showing that reserve carried over from the books of the Hackfeld Company?

Mr. Wild: Well, I am going to object to this. Counsel asked yesterday for the ledger reserve. May I state for this record that representatives of the Internal Revenue Bureau went down and they have gone all through these records. Counsel knows everything that is in them. He gave copies to them.

Mr. Atherton: This is a De novo proceeding, and counsel should understand that. And it is up to him

(Testimony of Harold C. Eichelberger.)

to prove his case as it goes along, regardless of what was submitted to the Bureau of Internal Revenue or any other Government officials prior to this suit. Now, the Government insists upon determining whether or not there was any book or books of original entry showing the carry-over from the Hackfeld Company, the so-called reserve against which these litigation expenses were charged. These books are secondary books, the ledgers?

The Witness: This is a primary record.

Mr. Atherton: Primary record?

The Witness: The ledger record.

Mr. Atherton: It is a ledger record?

The Witness: Yes.

Mr. Atherton: But it is a subsidiary book.

Mr. Wild: Your Honor, counsel just seems to be arguing with the witness. The witness told him it is a primary record.

The Court: Well, he said primary record. I get the point of course that everything in the ledger originated from some other source, either through the cash book or journal or some other account. That is what I understand counsel is inquiring about, and I don't know whether you expressed a desire to see those accounts or not. [133]

Mr. Atherton: What I wanted, your Honor, was to show the Court what the descriptive journal entry was on the book, original entry, where they reflected transfer of the setting up of this so-called reserve account to which these expenses were charged. Now,

(Testimony of Harold C. Eichelberger.)

I understand that the ledger entries showing the detail in the charge of the litigation expenses is for all purposes a book of an original entry here, because it is comparable to a day book. But when it comes to the account in which those entries were actually closed out eventually, that account was carried over, as I understand the testimony of Mr. Lowrey, from the books of the Hackfeld Company.

Now, I want to see what entries, what opening entries are made on the books of the taxpayer to record that transfer over.

The Court: I'd assume you'd have to see the journal entry, too, to get that. Is that not so?

The Witness: The first entries on this general reserve account are by journal entry, yes, are from the journal posting.

Mr. Atherton: Well, it is the journal posting what I'd like to see, what the journal showed as to setting up of that reserve. Do you happen to have that with you?

The Witness: I don't have the journal itself, no.

The Court: You can get it? [134]

Mr. Wild: Do you have a transcript of the journal entry?

The Witness: I have a transcript.

Mr. Wild: Which you prepared at my request?

The Witness: Yes.

Mr. Atherton: That will be satisfactory, your Honor.

(Testimony of Harold C. Eichelberger.)

Q. (By Mr. Wild): And do you have that transcript of the journal entry there with you?

A. I do.

Q. And what does that transcript show?

A. The original entry in account—do you want me to read it?

Q. No. You will identify that as an original, 'as a transcript of the entry? A. Yes.

Q. Were you treasurer or assistant treasurer of the company at that time? A. I was not.

Mr. Wild: We have here Mr. Lowrey who was the treasurer of the company at that time, and I called this witness to identify the records, and I'd like to withdraw this witness and put Mr. Lowrey on the stand. But he can go ahead and read this.

Mr. Atherton: I have no objection. It is perfectly [135] all right.

Mr. Wild: I was just getting the proper witness.

Mr. Atherton: I won't challenge his competency.

Q. (By Mr. Wild): Will you read that journal entry?

A. The first entry is dated December 31, 1918, journal folio 1604. The entry reads, "Debit, H. Hackfeld and Company, Limited, \$11,525.18; credit, special reserve account, \$11,525.18." The explanation furnished for that is book profit accruing to American Factors, Limited, on book balance of net assets purchased from H. Hackfeld and Company, Limited, as follows: assets as of January 1, 1918, \$13,675,504.21. Deduct liabilities as of January 1, 1918, \$5,750,510.43. Reserve for depreciation, \$413,-

(Testimony of Harold C. Eichelberger.)

468.60. Brought across is \$6,163,979.03, which subtracted from the assets of \$13,000,000 odd leaves \$7,511,525.18. Less capital stock issued of \$7,500,000. Difference, \$11,525.18.

Q. And the second journal entry?

A. The second journal entry is also dated December 31, 1918, folio 1605. Debit, H. Hackfeld and Company, Limited, \$733,898.27. Credit, special reserve account, \$733,898.27. The explanation given: additional book profit on book value of assets of H. Hackfeld and Company, Limited, as of August 20, 1918, purchased by American Factors, Limited.

Mr. Wild: No further questions. [136]

Mr. Atherton: No questions.

Mr. Wild: I will introduce the sheets in evidence for the convenience of the Court, and I will ask that the two be fastened together and marked as P-8.

The Court: Very well.

The Witness: I have these in duplicates.

Mr. Wild: Well, the original will be introduced in evidence.

The Court: That is Exhibit P-8?

Mr. Wild: Yes. I think that I asked this other exhibit that we were arguing about at the last session be marked P-8 for identification. And if that comes in, it should come in, I think, as P-8. So may this be marked as P-9?

(The documents referred to were received in evidence as Exhibits P-8 and P-9.)

(Testimony of Harold C. Eichelberger.)

PLAINTIFF'S EXHIBIT P-8

Hackfeld Litigation

Year	Dr.	Cr.	
1924	108,585.65		
Nov. 24	C. G. Heiser ticket.....	135.00	
Dec. 17	C. Brewer & Co.....	10,350.00	
	Alexander & Baldwin	10,350.00	
	H. P. Baldwin, Ltd.....	10,350.00	
	A. W. T. Bottomley.....	4,500.00	
	G. P. Wilcox.....	2,250.00	
	G. N. Wilcox.....	8,325.00	
	R. A. Cooke.....	112.50	
	F. J. Lowrey.....	2,250.00	
	C. M. Cooke, Ltd.....	4,500.00	
	George Sherman	4,162.50	
	E. D. Tenney.....	450.00	
	Castle & Cooke, Ltd.....	10,350.00	
	F. C. Atherton.....	1,125.00	
	J. B. Atherton Est.....	2,700.00	
	S. W. Wilcox.....	4,162.50	76,072.50
1925	198,114.32		
Aug. 15	C. Brewer & Co.....	8,050.00	
	Alexander & Baldwin	8,050.00	
	H. P. Baldwin, Ltd.....	8,050.00	
	Wm. Alexander	5,736.00	
	Alexander Prop. Co.	1,664.00	
17	W. F. Dillingham.....	600.00	
18	C. M. Cooke, Ltd.....	3,500.00	
19	Grove Farm Co., Ltd.....	6,475.00	
21	Castle & Cooke	8,050.00	
	F. C. Atherton	875.00	
	J. B. Atherton Est.....	2,100.00	
24	S. W. Wilcox.....	3,237.50	
25	G. P. Wilcox	1,750.00	
27	A. W. T. Bottomley.....	3,500.00	
Sept. 1	Matson Navigation Co.....	18,400.00	
	W. P. Roth.....	800.00	
	Andrew Welch	800.00	
8	Welch & Co.....	18,400.00	
	E. D. Tenney.....	350.00	
	R. A. Cooke	87.50	
Oct. 3	Geo. Sherman	3,237.50	
31	F. J. Lowrey.....	1,750.00	
	Forward.....	306,699.87	105,462.50
			76,072.50

(Testimony of Harold C. Eichelberger.)

Hackfeld Litigation (Continued)

Year		Dr.	Cr.	
1925	Forward.....	306,699.97	105,462.50	76,072.50
Dec. 17	Alexander & Baldwin		21,850.00	
	H. P. Baldwin, Ltd.....		21,850.00	
	W. M. Alexander		6,811.50	
	Alexander Prop. Co.....		1,976.00	
	C. Brewer & Co.....		21,850.00	
	E. D. Tenney.....		950.00	
18	R. A. Cooke		237.50	
	W. F. Dillingham.....		712.50	
	F. C. Atherton.....		2,375.00	
	J. B. Atherton Est.....		5,700.00	
21	F. J. Lowrey		4,750.00	
	Castle & Cooke		21,850.00	
	G. N. Wilcox		17,575.00	
31	S. W. Wilcox.....		8,787.50	
	C. M. Cooke, Ltd.		9,500.00	
	Matson Nav. Co.....		21,850.00	
	W. P. Roth.....		950.00	
	Andrew Welch		950.00	275,987.50
1926	.....	156,627.30		
Jan. 5	George Sherman		8,787.50	
4	A. W. T. Bottomley		9,500.00	
19	Welch & Co.....		21,850.00	
Feb. 26	Pillsbury, W. & S.....		7,500.00	
Apr. 24	Refund on Bond premium.....		10.00	47,647.50
1927	.....	6,255.49		
Apr. 30	G. P. Wilcox.....			4,750.00
1928	.....	12.27		
1929	.....	15,852.83		
1930	.....	832.00		
Feb. 28	Fee of Smith, Warren, etc. charged in error 12/24/29.....			2,539.28

(Testimony of Harold C. Eichelberger.)

Year	Dr.	Cr.
1931	4,519.68	
1932	484,805.00	
	<u>975,604.54</u>	<u>406,996.78</u>
Less credit	406,996.78	
	<u>568,607.76</u>	
Charged out as follows:—		
General Reserve	541,237.79	
Earned Surplus	27,369.97	
	<u>568,607.76</u>	

PLAINTIFF'S EXHIBIT P-9

12/31/18—J 1604

H. Hackfeld & Co., Ltd.....	11,525.18	
Special Reserve Account.....		11,525.18
Book profit accruing to American Factors, Ltd. on book balance of net assets purchased from H. Hackfeld & Co., Ltd., as follows:—		
Assets as of 1/1/18		13,675,504.21
Deduct Liabilities as of 1/1/18.....	5,750,510.43	
Reserve for Depreciation.....	413,468.60	6,163,979.03
		<u>7,511,525.18</u>
Capital Stock Issued.....		7,500,000.00
		<u>11,525.18</u>

12/31/18—J 1605

H. Hackfeld & Co., Ltd. }		
Special Reserve Account }		733,898.27
Additional Book Profit on book value of assets of H. Hackfeld & Co., Ltd. as of August 20, 1918 purchased by American Factors, Ltd.		

(Testimony of Harold C. Eichelberger.)

Mr. Wild: Now I'd like to withdraw this witness.

Mr. Atherton: No examination.

Mr. Wild: I'd like to have him leave these sheets in the custody of Mr. Lowrey. Thank you.

(Witness excused.)

Mr. Wild: Mr. Lowrey, will you take the stand?

SHERWOOD M. LOWREY

a witness in behalf of the Plaintiff, having previously been sworn, resumed and testified further as follows: [137]

Direct Examination

(Continued)

By Mr. Wild:

Q. Mr. Lowrey, there has been identified as coming from the custody of the company certain ledger sheets. Have you ever seen those before? (Handing exhibits to the witness.) A. I have.

Q. And are there the original entries showing the Hackfeld litigation expense there in the journal or in the ledger?

A. These are the original ledger cards.

Q. I see. And will you explain them to the Court?

A. I take it that the Court naturally is familiar with a ledger sheet. These cards here are simply the compilation, the compilation of the items that are charged to that account, and the items that in turn

(Testimony of Sherwood M. Lowrey.)

are credited to it, which takes and shows the entire transaction in a summary form, as indicated on the card.

Q. And I will show you the items in a copy of P-7 already adduced in evidence, and I will ask you if that P-7 is an accurate copy of one column of the cards and if so, what column?

A. With a hasty glance over here, I can see on this sheet here where there is one entry guided to this account incorrectly and has been taken out, with the exception of [138] a possible error like that which did not pertain to the Hackfeld litigation expense here, I feel confident that it is because this exhibit which I now have before me was made up by the chief accountant of the company and I presume after being typed was compared and is correct.

Q. Which column does that show?

A. This one that I now have.

Q. Yes, P-7.

A. That is the debit side. That is the charges.

Q. The debit side of the account, the charge side of the account?

Mr. Wild: I might say this: Does Counsel make any question of the correctness of the transcription of those items into P-7?

Mr. Atherton: We do not, your Honor. We have allowed that exhibit to go in without any objection.

Mr. Wild: So that counsel has checked these?

(Testimony of Sherwood M. Lowrey.)

Mr. Atherton: I am satisfied as to its correctness.

Mr. Wild: Now, I would ask that those be exhibited to the Court. But now I will ask for Exhibit P-8 for identification. I think the clerk has it there. Or was it returned to me?

The Clerk: You have it, Mr. Wild. I returned it to you last night.

Mr. Wild: Well, I had asked last night that P-8 be [139] marked for identification, that this be marked P-8 for identification.

Q. I will show you P-8 for identification and I will ask you to compare it with the original sheets now in the possession of the Court and state whether or not it is a correct transcript of items appearing on the account under heading of Hackfeld litigation expense? I think you have to look at the ledger sheets.

The Court: Pardon—go right ahead.

Mr. Wild: I want him to compare them.

A. It is practically the same as these cards.

Q. Well, what do you mean by “practically?”

A. There are one or two little things that apparently, as I mentioned—an error had been made which had been eliminated from the transcript in order to make this data which had been submitted in this memorandum form as clear as possible without having those errors show up in it. So far as I can see, the credits have been handled in a similar manner.

(Testimony of Sherwood M. Lowrey.)

Mr. Wild: Does counsel want to inspect them?

Mr. Atherton: No, I had them in front of me and I had been inspecting them. Just as a matter of information to the Court, I can't reconcile the two arithmetically. But I think for the purpose of the record I will accept the statement of Mr. Lowrey that the impossibility of reconciling of these two is due to the adjustment of the entries that [140] he has been talking about. We are not challenging that.

The Court: They both come out the same?

The Witness: The net will come out the same, your Honor.

The Court: I was just wondering what an item of dry goods, how that entered into the litigation?

The Witness: It is very possible that it was something from the dry goods department which handled the paper. It may have been that paper used by something in connection with drawing up exhibits or typing or something like that that had been charged into this account, because when the dry goods department gave it up they had to account for it to somebody. It was their property. Therefore, they charged it out to somebody. I say, I presume it could have been something like that. It could have been carbons. It could have been pencils. It could have been ink. It could have been any kind of stationery. I don't know to which item you are referring. That is the general explanation.

(Testimony of Sherwood M. Lowrey.)

Q. Mr. Lowrey, what column does P-8 show in that ledger account?

A. This shows the credits, subject to my former remarks.

Q. Yes. That is the credits, as I understand it; in P-8 they are the same as the credits in the ledger account after adjusting for erroneous entries? A. Correct. [141]

Q. In the ledger account? And in the P-8 on the debtor side, the figures that appear there, what are they?

A. They are simply the total of the expenses as shown in the exhibit. I think it was P-7.

Q. Yes.

Mr. Wild: We will offer P-8 in evidence, your Honor.

The Court: Any objection?

Mr. Atherton: No objection, your Honor.

The Court: Describe P-8. It is the summary transcript of the ledger account?

The Witness: It would be the summary as far as the debit is concerned but shows the credits in detail.

The Court: What do you call it?

Mr. Wild: I would think it is a condensed transcript. Is that an accurate statement, Mr. Lowrey? I am not trying to lead you. That P-8 is a condensed transcript of the credit account in the Hackfeld litigation expense?

The Witness: Yes.

(Testimony of Sherwood M. Lowrey.)

Q. The account as shown in the American Factors' ledger, is that correct?

A. Yes, a condensed statement. That covers the elimination of one or two items in there.

Q. And also it condenses the one figure on the debit side for the year, that is understood?

A. Yes. [142]

Mr. Cades: Condensed transcript of the Hackfeld litigation expense.

Mr. Wild: Mr. Cades has a better suggestion. I will ask him to make it to the Court. He is not only an attorney at law but concerned——

Mr. Cades: I'd suggest we call it the condensed transcript of the Hackfeld litigation expense account.

The Court: I just want some term to identify the exhibit in my notes. I got it.

Q. (By Mr. Wild): Now, Mr. Lowrey, you have there——

Mr. Wild: I will ask to withdraw the ledger sheets at this time and return them to the custody of—or if the Court desires to examine them further—does the Court desire to examine the original ones?

The Court: No, I don't have any desire.

Mr. Wild: As I understand it, we are not making any issue of any of the items in there except as they had been shown in either P-7 or P-8.

Mr. Atherton: That's right. No objection to withdrawing them, your Honor.

The Court: Very well.

(Testimony of Sherwood M. Lowrey.)

The Witness: The general reserve also.

Mr. Wild: Now, the general reserve account——

The Court: Submit it merely for inspection. The inspection, [143] as I take it, was made.

Mr. Wild: Now, we have produced these other accounts for examination by counsel for the Government, because the opening account is shown in P-9; closing account is shown in this exhibit P-8 where the Hackfeld litigation expense was charged off to reserve, general reserve, \$541,237.79. And then earned surplus, \$27,000. In other words, the closing out of this ledger account is shown on P-8, which is in evidence, so that the opening entry and the closing entry is shown. Does counsel for the Government desire any more inspection of those?

Mr. Atherton: No more inspection.

The Court: Well, all of that reserve, Hackfeld reserve account, was set up after the Factors took over, by reason of revaluation or something, is that so? Or did they, did the Factors inherit, so to speak, did the Factors inherit it? Was that account on Hackfeld books when the Factors took it over?

The Witness: That I cannot say. I was not treasurer of the company at that time. All I have to go on is what these records show.

The Court: Well, the dates would——

The Witness: And these records show here that they made certain adjustments, as has been explained by Mr. Eichelberger, as of the end of the year, December 31st, when the entry——[144]

(Testimony of Sherwood M. Lowrey.)

The Court: 1918.

The Witness: As of August 20th, I believe.

The Court: Well, did the Factors take over——

The Witness: August 20, 1918.

The Court: Well, up until that time the affairs, the management of the company had been where?

The Witness: In the Hackfeld and Company.

The Court: In Hackfeld and Company?

The Witness: As I remember it. I was in the service at that time.

The Court: The Alien Enemy Custodian, when did he come in?

Mr. Wild: Well, it is stipulated, your Honor, that he seized the capital stock of H. Hackfeld and Company, Limited.

The Court: That's all he seized?

Mr. Wild: He seized the capital stock. The business kept on going. Then there was a change of officers, but the business of H. Hackfeld and Company was carried on as it was before.

The Court: Under Hackfeld management?

Mr. Wild: Under Hackfeld management.

The Court: Up until August 20, 1918?

Mr. Wild: That's right.

The Court: And on that date the Factors went in?

Mr. Wild: That's right. [145]

The Court: And on the 31st they made an evaluation of the property and securities which accounted for the setting up of this reserve account?

(Testimony of Sherwood M. Lowrey.)

That is, they found upon analysis that the value of the property was seven hundred and some odd thousand dollars more than they paid?

Mr. Wild: That's right, your Honor, that the net value—and that is shown in P-9—the net value of the assets exceeded all known liabilities by \$733,898.27 plus the \$11,525.18. Now, I want to be accurate on that. It has been my understanding—Mr. Cades says he doesn't think it is quite right.

Mr. Atherton: Your Honor, the previous witness so testified, that is, what the journal entries showed.

Mr. Wild: I believe it is right.

Mr. Cades: I don't think that is the testimony.

The Court: I've got a transcript journal here in evidence.

Mr. Atherton: If I remember correctly, the testimony of Mr. Eichelberger—

The Witness: Eichelberger.

Mr. Atherton: —due to the effect that this so-called reserve or difference, what is the difference between the book values and the capital stock and the book liabilities, as shown at the date the transfer was effected in 1918—

Mr. Wild: Well, that is right. Mr. Cades corrected me in one small item, that is, that the first page of P-9 [146] shows that as it was at December 31, '18, that the special reserve account of \$11,525.18 had come over from the old account, and that the new amount of \$733,898.27 is at the end of that year.

(Testimony of Sherwood M. Lowrey.)

Mr. Cades: Might I explain, your Honor?

The Court: So eleven thousand dollars or something before that——

Mr. Cades: The eleven thousand dollars was set up and represented the difference between the assets and liabilities and capital at January 1, 1918, which was the last balance sheet apparently of Hackfeld. On August 20th, when the transfer took place, there was an increase in the amount of assets not representing the revaluation but earnings presumably from the first of the year up until August 20th which were not known when the first entry had been made.

Mr. Wild: As I take it, the net result was that there were some seven hundred thirty dollars more in assets found at the end of the year.

Mr. Atherton: Seven hundred thirty thousand you mean?

Mr. Wild: Yes, seven hundred thirty thousand. And whether or not it is earnings or not, it is assets.

Mr. Atherton: I think Mr. Cades said it did represent the earnings from January 1st to August 30th. I think he testified a moment ago——

The Court: Well he wasn't testifying. He was giving [147] his version of where the account originated. But the ledger, the journal entry, if that is taken to be as fact, that explains where it arrived from.

Mr. Wild: Now, we have no further questions about these original records. If Government counsel

(Testimony of Sherwood M. Lowrey.)

wants to examine them further now, he may; if not, may we turn them over to Mr. Eichelberger?

Mr. Atherton: Are you through with Mr. Lowrey as a witness so I can proceed to cross-examine him?

Mr. Wild: No. I was just wondering if it was convenient for you to cross-examine him on these records so we can send them back. I have quite a number more questions to ask him but not about these accounts.

Cross-Examination

By Mr. Atherton:

Q. Would you please look at P-7, Mr. Lowrey?

A. Which is P-7?

Q. It is that itemized list of litigation expenses.

Mr. Wild: That is in evidence. That is P-7.

Mr. Atherton: Yes.

Mr. Wild: But not for identification. It is in evidence.

Mr. Atherton: I am just identifying it.

Q. I wonder if you will tell the Court whether you have any knowledge about the character of the various expenditures itemized on this list?

A. I have, in a general way. I remember the——

Q. Now, then, would you follow through this list and notice down here on July 23rd there is a fee of one thousand dollars paid to Mr. C. R. Hemenway. Do you know whether or not there was any special arrangement as to when that fee was to be paid?

(Testimony of Sherwood M. Lowrey.)

A. We felt that Mr. Hemenway was being called away from his own business to take this particular task on. Mr. Hemenway was thoroughly familiar with every step that was taking place in connection with the organization, reorganization of Hackfeld and Company. And it was felt he would be entitled to additional compensation.

Q. Who was Mr. Hemenway?

A. Mr. Hemenway was a lawyer here who at this time, I think, had become assistant manager of Alexander and Baldwin.

Q. Was the amount of his fee fixed in advance or did it bear any relation to the outcome of the litigation?

A. That I cannot say. My recollection was, we felt, at least the steering committee felt that Mr. Hemenway should not be asked to go to the coast without proper compensation. And I think that the amount of compensation would depend upon the length of time this mission took him to the mainland.

Q. Now, following down that statement on July 31st, did you find an amount, fee paid, of one thousand dollars to Lucian H. Boggs? Who was Mr. Boggs?

A. Boggs, as I remember it, was an attorney in Washington, [149] D. C., and it was necessary that he be employed to gather certain information of the Alien Property Custodian's office.

Q. Was there any understanding, previous un-

(Testimony of Sherwood M. Lowrey.)

derstanding before the payment of the fee as to the amount what the services would be before he was engaged? A. None that I know of.

Q. Was there any understanding as to when the fee would be payable?

A. None that I know of.

Q. Now, you find further down on the statement of August 20th there is an amount of \$1,170.17 paid to Mr. Boggs, apparently for travel expenses. Oh, yes, it is a reimbursement, travel expenses, telephone, refunded to Mr. Boggs. Did he bill the American Factors for that or whom did he bill for that?

A. I do not remember whether Mr. Boggs was employed directly by the steering committee, who was in charge, or whether the attorneys in San Francisco who were hired in the case got Mr. Boggs to do certain things for them. And when the bill was submitted to us, it was paid.

Q. Well, do I understand from your testimony that you don't know whether Mr. Boggs represented American Factors or these other 23 co-defendants?

A. It was all so involved and mixed there together, that he was representing both parties. In other words, the [150] defense of the general suit.

Q. How about down here on the list, September 26, 1924, there is a payment of three thousand dollars, fees shown to have been paid to the law firm

(Testimony of Sherwood M. Lowrey.)

of Smith, Warren, Stanley and Vitousek; for what services was that fee paid and to whom?

A. It was paid to the law firm of Smith, Warren, Stanley and Vitousek for services in connection with this general matter. I presume that it was in connection with work they did relative to the duplicate suit that was filed in the Territory of Hawaii.

Q. Which suit?

A. The duplicate. It has already been discussed in the Court here to the fact that identical suits were filed in the Superior Court in San Francisco and in the Circuit Court of the Territory, but that the trial of the suit was going to take place in San Francisco. But it was necessary that certain steps be followed through in connection with the suit that was filed here in Honolulu.

Q. And would you say that this fee represented payment for services already rendered and completed by this law firm to the 23 co-defendants at that time?

A. I wouldn't say—it was probably on account. If I remember this, there were further fees paid to them as the case went along. The thing was not settled at that time [151] by any means, and I presume this was a payment on account.

Q. On October 25, 1924, the statement shows fees totaling two thousand dollars paid to Pillsbury, Madison and Sutro. Was that for services already

(Testimony of Sherwood M. Lowrey.)

rendered in accordance with the bills rendered by that law firm?

A. It was a payment made to them on account of services rendered.

Q. Was there any understanding with that law firm, to your knowledge, that their fees would be contingent upon the outcome of the litigation or on the part of the merit basis as they were rendered from time to time?

Mr. Wild: I object to that. It calls for the conclusion of the witness, on what merit is. Even courts disagree on that.

Mr. Atherton: I think I will rephrase it to avoid the objection.

The Court: I think it can be explained in connection in which it is used here. Do you understand it?

The Witness: My answer is, I don't know. I didn't make these arrangements with Mr. Sutro.

Mr. Atherton: Very well.

Q. The statement shows as of November 29th a fee of two thousand dollars paid to Eberhard Haynes. Who was Mr. Haynes?

A. Mr. Haynes was another attorney in the City of [152] Washington who had rendered services in connection with this whole matter.

Q. Do you have any knowledge as to what his arrangements were with respect to fees and services?

A. I do not believe there's any arrangement. He was called upon to render service from time to

(Testimony of Sherwood M. Lowrey.)

time, as it indicated, and it is my recollection that when his bills came in they were paid like any other bills in connection with this whole matter.

Q. Very well. Now, on December 16th, the statement shows fees to the, fees totaling fifty thousand dollars, paid to Oscar Sutro. What is your recollection about the arrangement respecting those fees?

A. The arrangement with regard to Mr. Sutro was fixed up by the steering committee. When his bill came in for fifty thousand dollars it was considered and ordered, and I was told to pay it.

Q. Now, that statement also show as of December 16th——

The Court: What year?

Mr. Atherton: 1924, your Honor.

A. Page 2?

Q. That is on page 2 of the statement. It shows the amount of eight thousand dollars recorded as final payment of fees to Lucian H. Boggs. Do you have any further explanation of that? [153]

A. No, sir. All I can make is the presumption.

Q. Now, on December 16, 1924, the statement shows the amount of \$7,113.25 fees and expenses paid to Smith, Warren, Stanley and Vitousek. Do you have any further explanation of that item?

A. Merely that these attorneys here were gathering information, one thing and another, following the case here, reporting presumably to Mr. Sutro, and it was in connection with the general expenses of the case.

(Testimony of Sherwood M. Lowrey.)

Q. For services rendered to date?

A. I wouldn't say that. I don't know.

Q. The statement shows as of December 27, 1924, the sum of five thousand dollars cash advanced to W. H. Lawrence of Pillsbury, Madison and Sutro. Will you explain to the Court what that advance was on account of?

A. W. H. Lawrence was an attorney in San Francisco, and he had been brought into the case by Mr. Sutro. This says fees, cash advanced to Lawrence. It may be a poor explanation but I should say it was a payment on account of fees for services rendered by Mr. Lawrence.

Q. A statement on page 3 as of February 19, 1925, shows the sum of \$2,266.67 paid to Pillsbury, Madison and Sutro as expenses for their December, January disbursements. Will you explain to the Court, please, more in detail what that means?

A. A detail with expenses I cannot give. I can make a presumption that there were a great many cable costs going through; possibly it could have been cable messages; it could have been some traveling expense; it could have been any number of items that they had taken and made an outlay and they are entitled to reimbursement.

Q. Very well. Now, the statement shows on page 4 as of February 28, 1925, the sum of \$46 sundries for binding 24 volumes of the Star-Bulletin, freight to San Francisco. Explain why that was regarded as a part of the litigation expense?

(Testimony of Sherwood M. Lowrey.)

A. None other than it was something other—the expense was incurred in connection with the case. In other words, the general principle followed through that if money was laid out in connection with the defense of this case, such amounts were charged up to this account.

Q. On March 12, 1925, the statement also shows disbursement of \$5.60 for newspapers to Sutro. Would your answer with respect to the explanation of that entry be the same as it was with respect to the \$46 item?

A. As I recollect, there was a lot in the newspaper about this case here. If you want to use this term, a hot subject was going on. There was a great deal of feeling in the community about it. Without question the newspapers had some articles in there that it was thought advisable [155] to pass on to Mr. Sutro. For some reason they were acquired and sent on.

Q. Now, the statement shows as of March 21, 1925, the sum of \$138.82, sundries, Yosemite Taxicab Company. Can you explain to the Court the particular relation of that expenditure to the conduct of the litigation?

A. I can again make a surmise, if you wish me to.

Q. No. If you don't know, just say you don't know.

A. I can say this, that there were many men from here who were in San Francisco testifying in

(Testimony of Sherwood M. Lowrey.)

the case. The court building was a considerable distance away from the hotel, and it was necessary to use taxi cabs.

The Court: Let us recess this case for a few minutes.

(A short recess was taken.)

After Recess

By Mr. Atherton:

Q. Now, Mr. Lowrey, we might save the Court time. If you will look at that Exhibit P-7, beginning at page 4, down to the end, particularly with respect to the fees paid to the various parties mentioned therein, state to the Court whether or not the testimony that you have hereofore given with respect to the other fees would be the same with respect to these, if I were to question you specifically with respect to each item?

A. I think it would be, namely, to the effect that [156] as services were rendered payments were naturally made for account of services as they went along. And in connection with these expenses here, it is very difficult at this stage to remember back which each one was, but at the time the expenses were incurred and authorized to be paid, they were analyzed carefully at that time and when payment was made they were considered as a proper litigation expense. It was charged to this account.

Q. Now, specifically, would you please look at page 9 of this exhibit as of January 19, 1926. You

(Testimony of Sherwood M. Lowrey.)

will note that the statement shows the amount of \$100,000 representing the balance of the fee paid to Oscar Sutro.

A. I notice that.

Q. What would be your statement by way of explanation of that?

A. I have none to make other than what it says right here on the face of it. That was a matter that was handled entirely, an amount like that, handled by the steering committee, and they apparently authorized it to be paid, and it was so paid.

Q. Now, if you will look at that same statement on that same page, as of March 23, 1926, it shows an additional sum of \$50,000 paid to Oscar Sutro. Can you reconcile the two statements appearing thereon with the previous one, that \$100,000 that represented the balance of the fee payable to [157] Oscar Sutro, and yet there was additionally paid to him the sum of \$50,000 at a later date?

A. As a recollection, the balance of the fee, the January 19th item might have been the balance of the fee, in connection with the case before the Superior Court. Then, as the testimony has already showed, there were appeals made and further work was done in the case, as more services were rendered.

Q. In other words, you would say, then, that the \$100,000 fee was paid, the balance of the fee

(Testimony of Sherwood M. Lowrey.)

paid to Mr. Sutro for services rendered in the lower courts?

A. I say that is a possibility, because I was merely the accountant, so to speak, when those big matters came up. It was passed by this group, and I was told to pay the money.

Q. Now, over on page 11 of the statement, as of July 28, 1932, there appears thereon the sum of \$85,000 paid to Mr. Oscar Sutro, stated to represent the final fee including that due associates. Do you know whether or not that fee included services rendered by Mr. Sutro and his associates during the calendar year 1930 and 1931?

A. I do not know that specifically.

Q. What other explanation can you give the Court with respect to that payment?

A. Well, the hundred thousand dollar fee that you mentioned I think was in 1926, was it not? Yes, in 1926. Then [158] the fifty thousand came in March 23, '26. As the record shows, the case was not finally determined until 1932. And as these various steps were taken in the case, it took legal service in connection therewith. And hence a 6-year period elapsed there. I presume this was the balance of the fee for those services.

Q. After the conclusion of the proceedings in the lower court, is that correct?

A. Yes, but of course the decision in the lower court was appealed and it was necessary to follow the case through to its ultimate conclusion.

(Testimony of Sherwood M. Lowrey.)

Mr. Atherton: I think that is all the examination that I care to make with respect to this particular exhibit.

The Court: I am curious to know——

Mr. Wild: I'd like you to ask the witness any question you want, your Honor.

The Court: Well, I am curious to know why they paid Atherton Richards thousands of dollars, seven thousand at one time, and then lesser sums at different times?

The Witness: Atherton Richards was not a member of a law firm. His name was given——

Mr. Wild: Not a law firm?

The Witness: Not a law firm; an engineering and consultant and appraising firm. I forget the name of the concern. It was at Mr. Richard Cooke's request that he was [159] brought in to try and establish the value of certain of the plantation holdings. I recollect a question in the case had to do with value in that the complainant had charged they received ten million dollars less than what was the proper value. And it was necessary to get some outside talent in there, impartial witnesses, who could take and make an analysis of how certain plantation earnings, and so forth, were in order that they could arrive at what would be considered a fair value of the plantation stocks which Hackfeld and Company owned.

The Court: Well, he was one of the subscribers, wasn't he?

(Testimony of Sherwood M. Lowrey.)

The Witness: Atherton Richards, no, sir. At least I do not think so.

The Court: Frank Atherton, money, different times, \$500. You don't know about that?

The Witness: A large number of these men had to go up to San Francisco in order to be witnesses in the case in San Francisco, and it was felt it was proper to take and pay them an amount to cover their travel expenses and hotel bills while in San Francisco.

The Court: Why did they pay the Alien Enemy Custodian here, Richard Trent, \$5,000 and various other sums, do you know?

The Witness: If I remember correctly, Mr. Trent went [160] up and was a witness on the stand there for many, many weeks. And these expenses of living up there were all coming against him as an individual.

The Court: Well, it was 'way in '26 in March that he was paid \$5,000. Would that apply to Walter Dillingham who received a thousand dollars in one payment?

The Witness: I think so. It was a procedure that was used with all of these witnesses. And there were a great many of them that were called to the coast. While this was going on it was necessary to take and have these men go up, and after point after point was brought up there by the complainant up there, it was necessary to send down here to get witnesses to go up and refute those

(Testimony of Sherwood M. Lowrey.)

things and also to take and gather information here which the firm of Smith, Warren, Stanley and Vitousek did of gathering data to send up for the use of counsel who was appearing for the group.

The Court: Well, Trent was named as a defendant? All right.

Mr. Wild: Any other questions your Honor wants to ask?

The Court: No.

Direct Examination

(Continued)

By Mr. Wild:

Q. Mr. Lowrey, at the time these amounts were paid, who directed the payment of them?

A. The payment that is made on account of these expenses? [161]

Q. That's right.

A. The ordinary, customary and regular ones I directed the payment of them. The bigger ones, why, these larger fees and the payments of the individuals concerned for travel expenses, it passed the group, the steering committee.

Q. What do you mean it passed them?

A. Well, they passed on it and told me to pay it.

Q. I see. And at the time when—I take it this is the substance of your testimony—at the time when that was fresh in your recollection as it occurred, you knew of your own knowledge about the

(Testimony of Sherwood M. Lowrey.)

minor expenses and what they were for and passed them? A. Yes.

Q. Under general direction from the committee, the so-called steering committee, is that correct?

A. That's correct.

Q. And the larger items were all passed on by the steering committee, and you were told to pay them? A. That's correct.

Q. Now, Mr. Lowrey, are the members of that steering committee now living or dead?

A. All dead.

Q. And the last survivor, Mr. Charles R. Hemenway, just recently died? A. Yes. [162]

Q. I think you said the local firm of Smith, Warren, Stanley and Vitousek were employed in connection with the San Francisco litigation.

A. They were.

Q. And what were the duties in regard to that, if you know?

A. Well, following the suit that was filed——

Mr. Atherton: Your Honor, I think that the witness is not qualified to answer that question. I think the members of that law firm would be the only parties who can properly answer that question.

Mr. Wild: He can say. He knows as a businessman that this firm furnished services by investigating evidence here. That is part of his job. He knew it. I don't think you need an attorney at law, a member of the firm to testify to that. And

(Testimony of Sherwood M. Lowrey.)

I am merely referred to things brought out in cross-examination on the point. That is all.

The Court: Well, I took the point of the cross-examination to be more as to the time when the payments were made, and if that settled the business up until that time, not an inquiry as to what the services were. And I don't know—so long as they were engaged and paid for for legal services, I don't see where the Court can be concerned with that.

Mr. Wild: I don't either, your Honor. And that is why I was clearing it up. [163]

Now, may I return to direct examination and ask that the Court permit me to withdraw the original exhibits and turn them over to the custody of Mr. Eichelberger?

The Court: Well, yes. They haven't been made exhibits?

Mr. Wild: No.

The Court: They were here for examination?

Mr. Wild: Examination, your Honor. Mr. Eichelberger, if you will take them, and then I'd like to resume my examination of Mr. Lowrey.

Q. (By Mr. Wild): Mr. Lowrey, you were treasurer of American Factors in the years '31 and '32, as you have already testified? A. I was.

Q. During the latter part of the year '31 or the early part of the year '32, calling your attention to that time, was there any discussion with Mr. Bottomley concerning the Hackfeld litigation expenses?

(Testimony of Sherwood M. Lowrey.)

A. There was.

Q. And can you place about the time of that discussion which you had?

A. I'd say it would be the early part of the year, that is, '32.

Q. '32? A. Early part of '32.

Q. Can you remember any more definitely? Was it after [164] the final decision in the Supreme Court of California?

A. Yes, it was after that.

Q. After that?

Mr. Atherton: Your Honor please, I object to counsel leading the witness.

Mr. Wild: Well, I was just trying to fix a time.

The Court: Yes. The matter of memory, recollection of a date as old as that, I see no evil in it. You can't fix the date?

The Witness: Not the exact day the conversation took place. To say January or Februry of '32, no, sir, I cannot.

Q. Was it before or after the report had been received or the decision of the Supreme Court of California in the Hackfeld litigation?

A. Afterwards, as I recollect.

Q. And where was that conversation?

A. Either in Mr. Bottomley's office or my own. The two offices were adjoining. Sometimes he would call me in there; sometimes he would come out and talk to me in my own office.

(Testimony of Sherwood M. Lowrey.)

Q. And that was in the old Hackfeld building, now the American Factors building?

A. That is correct.

Q. Down on Fort and Queen Street?

A. Yes, sir. [165]

Q. Honolulu? And was there any discussion concerning the Hackfeld litigation expenses at that time?

A. Yes. The decision had been rendered in the Superior Court, with which this Court is now familiar. There had been the appeal to the Supreme Court of the State of California. It had been successful there. It was then some other legal step in connection with the Remitter—is it not?

The Court: Yes.

A. I think that is the legal term, the details of which I am not conversant with. They were successful in that. Then there was a further step, as I remember it, in connection with the Supreme Court of the State of California, successful there. And at that time it was felt that the case was——

Mr. Atherton: Excuse me, your Honor. He is purporting to say what was felt.

Mr. Wild: No, what was said.

The Witness: I was going to say that I felt and others agreed with me to the effect that our effort had been successful, that the case was practically closed. There was only one further step that could have been taken, and that was to have it reviewed by the United States Supreme Court, which was

(Testimony of Sherwood M. Lowrey.)

later attempted and which was denied. In connection with the expenses, in view of the fact that the whole formation of this company was involved, every stockholder was involved, [166] it seemed right in my opinion, and in the opinion of others, that the expense of all this litigation should become a company expense rather than to have the burden of something in excess of half a million dollars thrown on the shoulders of a group, with which the court is familiar, and make them bear it; where it had been their efforts in creating American Factors, their efforts had been successful in creating and bringing into being this organization which was to be a benefit to the community and to the other 600 odd shareholders.

The Court: Well, I think that you rather are taking advantage of your opportunity to answer the question by making a speech telling what your personal views were. I think you have gone 'way beyond the answer to the question.

Mr. Atherton: Your Honor anticipated my objection. I was going to move here that we strike Mr. Lowrey's testimony as not being responsive to the question and as extending far beyond what would be necessary and responsive in reply.

Mr. Wild: I have called attention to the Court before that there isn't any such objection——

The Court: We won't strike it. Go ahead with your examination.

Q. (By Mr. Wild): Mr. Lowrey, what, if any,

(Testimony of Sherwood M. Lowrey.)

statements did Mr. Bottomley make to you concerning these litigation expenses and his investigations concerning them? [167]

A. He told me that he had conferred with Mr. Oscar Sutro, who had been chief counsel for the defendant, and that he, Mr. Sutro, had advised Mr. Bottomley that in the opinion of Mr. Sutro the expenses incurred——

Mr. Atherton: Your Honor, I object to that as hearsay.

The Court: Well, that is hearsay all right.

Mr. Wild: Your Honor, the subject matter here is to prove the fact of an opinion given in an official course of conduct of American Factors' business from the president of the company to the treasurer of the company, for the information of an officer of the company in this matter at a time when there was no thought of any Federal income tax question or any other thing involved in it, your Honor. And I take it——

The Court: I know, but for the witness to undertake to tell what motives Mr. Bottomley was acting upon due to something that someone had told Mr. Bottomley, it is rather going too far. It is in the field of hearsay.

Mr. Wild: Well, your Honor, what I have asked him about, if there was an opinion given of counsel at that time.

The Court: Well, does the witness know?

The Witness: Yes, there was.

(Testimony of Sherwood M. Lowrey.)

Q. Do you know whether or not there was an opinion of counsel, Mr. Sutro, given at that time?

A. There was. [168]

The Court: A written opinion?

The Witness: That I do not know, Judge.

The Court: Well, how do you know there was an opinion?

The Witness: Because I was so told by Mr. Bottomley.

The Court: Well, that is the basis, then, for your belief that there was an opinion given?

The Witness: Yes, sir.

Q. And what was that opinion?

A. The opinion was——

Mr. Atherton: That, your Honor, I object to. The best evidence of that opinion is either the written opinion itself or Mr. Sutro.

Mr. Wild: Well, your Honor—is Mr. Sutro living or dead?

The Witness: He is dead. He died many years ago.

Mr. Wild: I know that of my own knowledge.

Mr. Atherton: Well, some member of his firm, certainly not the witness. The opinion wasn't given to him.

Mr. Wild: He has a report of an opinion that is given by the president of the company to the treasurer, and the treasurer with knowledge of that opinion acts on it in part. This isn't a case——

The Court: I don't follow you there that the

(Testimony of Sherwood M. Lowrey.)

treasurer acted on some opinion that Mr. Bottomley said was given to him. I understood the witness to say that from time to time he acted upon directions, instructions, except as to certain [169] smaller matters of finance that were left to his own discretion. But upon the larger matters, matters of policy, that he received directions. He testified that Mr. Bottomley investigated, told him what to do, to be sure. But as to the motives that impelled Mr. Bottomley to tell him what to do or advise him, I think it is too far.

Mr. Wild: Very well. May we have an exception to your Honor's ruling?

The Court: Yes.

Mr. Wild: And in that connection may I make an offer of proof, your Honor? I will prove that Oscar Sutro——

The Court: Yes.

Mr. Wild: ——the head counsel for the group of defendants in the cause, gave an oral opinion to Mr. Bottomley, now deceased, or partially in writing, now lost, to the effect that in Mr. Sutro's opinion as a lawyer the total expense of the Hackfeld litigation was a legal liability of American Factors, determined as such at the conclusion of the litigation.

The Court: Do you want to follow that?

Mr. Atherton: I want to remark that his offer of proof should be confined to the fact that Mr. Sutro gave an oral opinion, expressed an oral opin-

(Testimony of Sherwood M. Lowrey.)

ion to Mr. Bottomley, and not what the text of that opinion was.

Mr. Wild: Well, I can show what the opinion was, too, [170] if I want to.

Mr. Atherton: I don't believe he may do that, your Honor.

Mr. Wild: Of course I can.

Mr. Atherton: It would be objected to on the basis of hearsay.

Mr. Wild: This has nothing to do with hearsay. This is part of the *Res gestae* of the whole situation, your Honor, as I see it.

The Court: Well, do you want to put him to the proof, then? He made an offer of proof.

Mr. Atherton: Yes, I want him to prove the opinion by Mr. Sutro.

Mr. Wild: But Mr. Sutro is dead.

Mr. Atherton: He can do it by any competent witness.

The Court: Well, let him go forward with his proof, then.

Mr. Wild: Well, your Honor, I said I'd offer to prove it by this witness, that that was a report made by Mr. Bottomley.

The Court: I didn't understand you to say that this witness would prove the report made by Mr. Bottomley in your offer to prove.

Mr. Wild: Well, let me make it clear, then, your Honor. I offer to prove that this witness will testify that Mr. [171] Bottomley informed him that

(Testimony of Sherwood M. Lowrey.)

Mr. Oscar Sutro, the head counsel for the company, had made the statement concerning the opinion about which I have just stated, and that Mr. Oscar Sutro is now dead. I think that is in evidence. And that is part of the *Res Gestae* and we offer it as such.

Mr. Atherton: My objection, your Honor, is the same as it was when the witness undertook to testify, that he is not qualified to testify; it is hearsay testimony. The best evidence of the opinion expressed by counsel is either counsel's statement as to that opinion or the written opinion or a copy thereof, if the original cannot be accounted for.

Mr. Wild: Well, all opinions aren't written, your Honor. I give many opinions. I gave one this morning in a very complicated matter. And, as your Honor well knows, there are many of them that are oral opinions, and when they are so given in the course of conduct of a matter they form part of the *Res gestae* and they are not hearsay so far as the Government is concerned in any tax case. They are not hearsay at all. They are just part of the *Res gestae*.

The Court: Well, perhaps it wouldn't be hearsay coming from Bottomley, but coming from someone whom Bottomley quoted as being the statement of someone else, I can't help but believe that it does come within the hearsay rule.

Mr. Wild: Well, does your Honor so rule?

The Court: Yes. [172]

(Testimony of Sherwood M. Lowrey.)

Mr. Wild: And we may have our exception to that ruling?

The Court: Yes.

Mr. Wild: I want to make clear the grounds of what my exception is, that the statement by the president of the company to the treasurer of the company made after the decision of the Supreme Court of the State of California had become final, was a part of the *Res gestae* and as such not hearsay. It is part of the *Res gestae* in this whole matter, what they were doing and what they were discussing, and what they were acting on at that time.

The Court: The exception is noted. Go ahead.

Q. (By Mr. Wild): I will show you, Mr. Lowrey, what purports to be a copy of an opinion from the firm of Smith, Wild and Beebe, dated March 3, 1932. I will ask you if you examined that?

A. I have.

Q. And to the best of your knowledge is that a copy of an opinion which was furnished to American Factors, Limited? A. It is.

Mr. Wild: I have already furnished counsel with a copy of the letter.

Mr. Atherton: What is the date of the opinion?

Mr. Wild: March 3, 1932. I note that this copy is not signed. I think it was signed, it was made from a copy in our files, which was not signed, your Honor, and I think the [173] Government has a signed copy of it.

(Testimony of Sherwood M. Lowrey.)

Mr. Atherton: Wait a minute. I want to get the signed copy in.

Mr. Wild: I think it is signed by Arthur G. Smith. It is just as much hearsay in this as the other, but I don't care. The Government wants it in. Maybe we made too much about Sutro's opinion, your Honor. It is in the contemporaneous corporate records, to wit, the minutes of the stockholders' meeting, and it is reported and it is annexed to our exhibit. But I was asking this witness about it because he had knowledge of his own. May the record show that this was signed. That is wrong; it is Arthur G. Smith; he never had an initial "T". This letter was signed "Smith, Wild, Beebe and Cades by Arthur G. Smith." But the form which I have here is in blank, your Honor, because we didn't have a signed copy in the office. Except for that, that is a copy of the letter.

The Court: Did the witness see the original?

The Witness: Yes.

The Court: When?

The Witness: Shortly after it was received. Bottomley passed it out to me to read.

Mr. Wild: And we'd offer this letter in evidence, asking that it be marked by the clerk in the blank space as Arthur G. Smith. [174]

Mr. Atherton: No objection.

Mr. Wild: The Government has no objection because they asked that I put this in.

(Testimony of Sherwood M. Lowrey.)

The Court: That is exhibit—you want to follow these P's?

Mr. Wild: Yes, for the plaintiff; P-10.

The Court: That would be P-10, then. Letter of, what date?

Mr. Wild: March 3, 1932.

(The document referred to was received in evidence as Plaintiff's Exhibit P-10.)

PLAINTIFF'S EXHIBIT P-10

March 3, 1932

American Factors, Limited,
Honolulu, T. H.

Attention: Mr. A. W. T. Bottomley,
President.

Gentlemen:

You have asked for our opinion on two questions: (1) whether reimbursement by American Factors, Limited, of the individual respondents in the various suits entitled "J. C. Isenberg, et al, Complainants, vs. George Sherman, et al, Respondents", is within the corporate powers of your corporation; and (2) whether if question (1) is answered in the affirmative your corporation is under a moral obligation to make such reimbursement.

You are hereby advised that in our opinion under the facts as hereinafter stated, both questions should be answered in the affirmative.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

In order that your stockholders, officers and directors may be advised as to the reasons for this opinion, we deem it advisable to incorporate herein a brief summary of the important events out of which the litigation arose.

H. Hackfeld & Company, Limited, an Hawaiian corporation, was during the World War and prior to 1918, apparently because of the nationality of certain of its directors, officers and stockholders, blacklisted by the British authorities and under suspicion by the United States authorities, and its cable communications and also its importation of certain supplies necessary in its business had been stopped. Apparently all of the shares of stock, except 1400 shares which had been sold to certain Americans in 1916, was held by Germans or by American citizens of German birth or parentage.

The actual management of the company's affairs was in the hands of Messrs. Rodiek, Hagens and Humburg. Mr. Hagens was acting manager at Honolulu, while the other two were in San Francisco. The Trading with the Enemy Act had been passed in October, 1917, and Mr. Hagens had apparently become very much discouraged over the future of the company, and after taking the matter up with the two above-named who were in San Francisco, it was decided that the only thing to do was to "Americanize" the corporation, and that if this were not done the corporation would go to pieces.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

A scheme of reorganization was worked out by the three and the other directors of Hackfeld & Company, under which a majority of the stock would be turned over to American citizens not under suspicion. The matter was taken up with the Alien Property Custodian, but was not satisfactory to him for reasons which need not be detailed herein, except to state that he considered it contrary to the procedure required by him under the Trading with the Enemy Act, and that he believed he should effect his own reorganization.

Accordingly the scheme devised by Mr. Hagans et al was unscrambled, the stock which had been transferred to American citizens under that scheme was turned back, and the Custodian started to effect his own reorganization.

During the course of the proceedings, three plans were outlined as a possible solution: (1) A sale of the enemy-owned stock of the company in somewhat the same manner as had been suggested by Hagans, et al; (2) The disincorporation and the sale of the company's assets by piecemeal; (3) The sale by the corporation of its entire property and business as a going concern to a new corporation to be organized under the laws of Hawaii for that purpose. Incidentally, it might be stated that when Messrs. Hagans and Humburg went to Washington, together with Judge Frear, to attempt to secure the consent of the Custodian to their first scheme, both Hagans

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

and Humburg, according to the decision of Judge Murasky, repeatedly stated that \$180. a share would be a fair price for the Hackfeld stock.

It should also be noted that if the corporation's assets were sold piecemeal this procedure would have benefited primarily existing sugar agencies, since they would naturally have succeeded to the agencies of the various corporations represented by Hackfeld & Company.

The Custodian insisted upon the third possible plan, to-wit, the organization of a new corporation. He set a figure of \$7,500,000., or \$300,000. more than the value which Hagens had fixed on the 40,000 shares of Hackfeld stock, disregarding the admitted lower value of the 3,000 shares of preferred stock constituting a part of the 40,000 shares.

The organization was carried through according to his views and resulted in a price to the Hackfeld stockholders of approximately \$194. a share instead of \$180. a share.

American Factors was incorporated for \$5,000,000., with 50,000 shares of the par value of \$100., and pursuant to the plan of the Custodian, this stock was offered at \$150. a share, resulting in a total of \$7,500,000., the price fixed by the Custodian as the value of Hackfeld & Company's assets, and the payment of \$194. a share to the Hackfeld stockholders, although J. F. Hackfeld, Limited, had in January, 1918, sold 11,000 shares of its stock in H. Hackfeld

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

& Company, Limited, for \$180. a share. J. F. Hackfeld, Limited, was an Hawaiian corporation, nearly all of the stock of which was owned in Germany, and which owned 12,647 shares of stock in H. Hackfeld & Company, Limited.

The Alien Property Custodian had, under his authority, seized all of the Hackfeld Company stock owned by alien enemies, and this stock was voted under the reorganization pursuant to his instructions.

In July, 1918, a special meeting of the stockholders of H. Hackfeld & Company, Limited, was called to vote upon the question of the transfer of the assets of that company to American Factors, Limited. At this meeting every share of stock in the corporation, except 160 shares held by one stockholder who later ratified the proceedings, was voted in favor of the reorganization and in favor of the sale to American Factors, Limited, for approximately \$7,500,000.

Certain of the respondents in the Isenberg suit were named as trustees to handle the financial end of the reorganization. The details of their operations, which were pursuant to instructions from the Alien Property Custodian, need not be detailed here, except to state that twenty-three of the respondents submitted a joint subscription for a total of 27,000 shares of the 50,000 shares of American Factors, Limited. According to the Supreme Court

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

in California, the purpose of this group subscription was eminently proper inasmuch as if they were to invest approximately \$4,000,000. in the new enterprise they were entitled "to be sure that at least half of the stock of the new company should be held by those who would bring skill and experience in the sugar business to the new corporation".

The first Bill in Equity was brought in December, 1924, and substantially identical actions were filed both in Hawaii and in California.

The Complaint alleged that the assets of Hackfeld & Company were worth approximately \$17,500,000. and that the sale to American Factors, Limited, resulted in a loss to the Hackfeld & Company stockholders of approximately \$10,000,000., that the entire proceedings were the result of a conspiracy on the part of all the respondents, including American Factors, Limited, and that American Factors, Limited, after taking over the assets so mismanaged the business as to cause a further loss of approximately \$2,500,000.

The Complaint alleged that American Factors, Limited, took over the assets with full knowledge of the conspiracy and with full knowledge of the equities of the stockholders of Hackfeld & Company, and that with such knowledge, had mismanaged the assets so as to cause the above damage to the old stockholders. It was further charged that American Factors, Limited, with full knowledge of the rights

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

and equities of the complainants on or after July 11, 1924, made transfers on its stockbooks to the purchasers of the stock, as a part and in consummation of the general fraudulent scheme, although notified by the complainants of their objection thereto and of their alleged rights and equities.

The Complaint prayed for accountings from the various respondents and full disclosure of their respective acts, including the acts of those respondents who served as trustees, and prayed for an order and judgment of the court that the officers and directors of American Factors, Limited, make an accounting of their doings as such officers and directors, that American Factors, Limited, be directed to hold that portion of the assets and business which it had received from Hackfeld & Company in trust for the complainants, and subject to the satisfaction of any judgment that might be entered; that judgment be entered against American Factors, Limited, together with other respondents in favor of the complainants in such sum as the court might find the complainants entitled to; and also that judgment be entered against American Factors, Limited, specifically for such amount as the court might find the respondents had been injured by the mismanagement and breach of fiduciary duty committed by American Factors, Limited. This Complaint apparently did not seek to have the reorganization set

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

aside. It was instead an attempt to secure a money judgment, but we are informed that recently all or certain of the complainants brought suit in the State of New York, one of the purposes of which was to secure a rescission of the entire transaction.

In June, 1924, upon information reaching the directors that a suit was contemplated, your president was authorized and instructed by the Board of Directors to take the necessary steps to secure counsel to handle the case for the corporation, and the services of Mr. Oscar Sutro were definitely secured shortly thereafter, and other attorneys were subsequently engaged to assist him.

These attorneys prepared a joint answer on behalf of all the respondents, including your corporation, and this answer was signed by the attorneys as counsel for all the respondents and was sworn to by two individual respondents, the oath of all respondents in a case of this kind being unnecessary.

From the foregoing it appears that your corporation was vitally interested in the outcome of the litigation in all of the suits which had been brought by the complainants, and also that the acts of the respondents upon which the suits were predicated were intended to be and were for the benefit of the corporation, and while we do not consider it necessary at this time to go into a discussion of the authorities, as we stated at the outset of this opinion it is our view that any such reimbursement is within

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-10—(Continued)

the powers of the corporation; in other words, such payments would not be ultra vires; and that your corporation is under moral obligation to make such reimbursement upon proper authorization of the stockholders.

Very truly yours,

SMITH, WILD & BEEBE,

By /s/ ARTHUR G. SMITH.

AGS:F

The Court: Do you want to adjourn now?

Mr. Wild: If it would meet your Honor's pleasure. I think I will close with my opening of Mr. Lowrey on this issue.

The Court: Now let's sort of take stock about how far we are along here. This is a day and one-half. Are we halfway through?

Mr. Wild: From my angle, your Honor, I have practically completed the Hackfeld litigation. The pension fund wouldn't take us 10 minutes I don't think. The Henry Waterhouse Trust Company matter I think I could finish with my witnesses in one day. And I don't know whether the Government has any or not.

Mr. Atherton: Your Honor, I would like to cross-examine Mr. Lowrey after lunch, and I don't think it will take more [175] than an hour at the most to complete that. And then I would say that unless

(Testimony of Sherwood M. Lowrey.)

Mr. Wild wishes to further examine him that that would probably close the Hackfeld issue. As far as the Waterhouse note issue is concerned, I doubt if the Government has any particular witness to put on the stand.

The Court: Well, now, the plaintiff will probably finish its case by noon tomorrow, is that right?

Mr. Wild: I would think so.

The Court: Well, then, the Government will take about how long?

Mr. Atherton: The facts on the Waterhouse issue have been substantially stipulated to, so that unless they are going to be supplemented by some testimony that plaintiff will put in——

The Court: Then as to argument.

Mr. Atherton: Well, I will make the Government's argument at the conclusion of Mr. Wild's argument, and I think if he can tell the Court about how long he will take, why, I can probably approximate how long I will take.

The Court: All right, Mr. Wild, how long do you think you will take in the argument?

Mr. Wild: I think if your Honor could allot me an hour and one-half for opening and closing, or an hour——

The Court: Yes, I can do that.

Mr. Wild: You see, I have the privilege of opening and [176] closing, as I see it. And I am in the dark as to what counsel's position is. I have already given him my brief, a preliminary one, so

(Testimony of Sherwood M. Lowrey.)

that he knows some of the cases that I have in mind to present.

The Court: That is this preliminary statement that you gave to me yesterday?

Mr. Wild: Yes, your Honor. There are also some technical questions in there which I haven't yet called to your Honor's attention other than the memorandum on the pleadings, for instance. The Government failed to answer the allegations in a number of paragraphs in our pleadings. Under the rule applicable that is an admission of all such allegations, in those particular paragraphs which were not denied or otherwise pleaded to; there was reference made in two of them to Exhibit A which set forth the facts in our claims. And those were not denied. And under the rule, Rule 10(c), they are part of the pleading. And if not otherwise denied, they are all admitted.

The Court: The new standard rules for District Courts, were they in force at the time the answer was made?

Mr. Wild: They were in force at the time before the complaint was filed, your Honor, because I had to look up and get my complaint within the rules. It was new pleading to me, your Honor, and therefore I have a skeleton of the whole thing. So that these technical questions of pleading I don't [177] want to press further than just to raise the issues, because they do raise some serious issues.

(Testimony of Sherwood M. Lowrey.)

The Court: I noticed that you mentioned that in this memorandum.

Mr. Atherton: Since counsel has mentioned that, your Honor, I want the record to show that I didn't prepare the answer to the complaint herein.

Mr. Wild: I know you didn't.

Mr. Atherton: But under the rules I intend to move to conform the Government's answer with the proof, and now I'd like the record to show that the Government would like to amend its answer to deny all the allegations contained in the claims for refund.

Mr. Wild: May it please the Court, we allege that once having admitted them under the rule of court that if that rule means anything the Government is bound by it just the same as I would be as an individual. It is too late now, may it please the Court.

Mr. Atherton: I'm sorry, your Honor, under the rules each party has an opportunity once as a matter of course to amend his pleading. And certainly the Government isn't going to be bound by the mistake, if it was a mistake, of some attorney in the department, and I don't admit that he did so, but if he did so overlook the way the complaint incorporated by reference, as it did, the claim for refund, certainly there [178] was no intent on the part of the Government attorney to admit any allegation contained in the claim for refund.

The Court: I don't see how Mr. Stainback, who was named in the answer, I don't see how he could

(Testimony of Sherwood M. Lowrey.)

represent the Government in this matter because it appeared to me from this exhibit here that he was employed and paid a fee in this litigation.

Mr. Wild: May it please the Court, it is nevertheless the answer of the Government. I don't care whether the Governor should refund something or not. Under the rules of court, if they mean anything, the defendant's motion comes too late by five years, approximately five years and nine months. Had there been a timely motion made immediately after answer filed, your Honor, we might have listened to it.

The Court: On April 29, 1925, is an entry, "Fees, I. M. Stainback, \$1,000." The same date, "Expenses, I. M. Stainback, \$245." I notice that Mr. Stainback, while he was U. S. Attorney here, made and filed the answer in the case.

Mr. Wild: May it please the Court, under the rule the pleading goes back to Washington, as your Honor well knows, where a collector, other official of the Government, is concerned, or other official is concerned. Also, as counsel for the Government has now stated for the defendant here, those answers are prepared in Washington and sent forward for filing here. The present counsel is representing the [179] Government in Washington. He is in no wise responsible for this matter. I know that. But it doesn't make any difference about these payments. That is the answer of the defendant in the case, and under the rule it is binding upon all parties in conformity

(Testimony of Sherwood M. Lowrey.)

with the rules. Now, if the Government had wanted to make a timely motion some five years and nine months ago, there might have been some merit in it. But it certainly comes too late when we have raised the issue in the trial that we are entitled clearly to the judgment of this Court because of the admissions made in the pleading; it certainly comes too late then to try to bring a new suit or a new case.

The Court: Well, shall we take an adjournment at this time until what hour?

Mr. Wild: What is convenient to your Honor—two o'clock?

The Court: Well, two o'clock is convenient, but then I want to finish this case this week if I can.

Mr. Atherton: Well, let's say 1:30, your Honor.

The Court: All right, 1:30.

Mr. Wild: I think we will proceed very rapidly with the rest.

(The Court recessed at 12:15 p.m.) [180]

Afternoon Session

Mr. Wild: Ready to proceed, your Honor.

The Court: Yes.

Mr. Wild: At this time I'd like to temporarily withdraw Mr. Sherwood Lowrey and have Mr. Eichelberger resume the stand.

HAROLD C. EICHELBERGER

a witness on behalf of the Plaintiff, having previously been sworn, resumed and testified further as follows:

Direct Examination

By Mr. Wild:

Q. Will you please state your full name again?

A. Harold C. Eichelberger.

Q. And you said this morning that you were assistant secretary also of the American Factors, Limited? A. That's correct.

Q. And as such, you have under your custody and control the minute books of the directors and stockholders meetings of American Factors, Limited?

A. That's right.

Q. I will ask if at my request you have brought with you a minute book from the official records of the American Factors, Limited? A. I have.

Q. And you have produced it in court here? What is [181] that minute book?

A. It is a book containing the minutes of the directors and stockholders meetings of American Factors, Limited, for a period December 27, 1922, to March 4, 1935. It contains an official and true record of the transactions.

The Court: What dates?

A. It contains the minutes for the period December 27, 1922, to March 4, 1935.

The Court: '22?

The Witness: 1922.

Mr. Wild: I'd like to withdraw Mr. Eichelberger and keep the book for a minute.

(Witness excused.)

WALTER T. VORFELD

a witness in behalf of the Plaintiff, being duly sworn, testified as follows:

Direct Examination

By Mr. Wild:

Q. Will you please state your full name?

A. Walter T. Vorfeld, V-o-r-f-e-l-d.

Q. And are you an official of American Factors, Limited?

A. I am presently the treasurer of American Factors, Limited.

Q. And in the year 1932 and before, what were you?

A. Beginning in the early part of 1931, I was secretary of American Factors and continued in that capacity until April [1932] of this year.

Q. You have seen this book which Mr. Eichelberger has identified? You know what that book is?

A. Yes, this is the minute book of American Factors for the period December 27, 1922, until March 4, 1935, containing the records, accurate and true records of the proceedings of stockholders and directors meetings of American Factors, Limited, as they were kept in the ordinary course of business.

Q. Very well. I will ask you whether or not you

(Testimony of Walter T. Vorfeld.)

have among those minutes, records of a stockholders meeting, annual meeting of stockholders of American Factors, Limited, held on March 4, 1932?

A. There is a record of such a meeting in this book.

Q. I will ask you whether or not, there is any reference in the text of that meeting to the Hackfeld litigation expense issue? A. There is.

Q. And where does it appear, on what page of that book?

A. It appears at page 224, starting with the last paragraph.

Q. And have you compared the statement with Exhibit 2-A annexed to P-5? A. Yes, I have.

Q. And is that annexed to P-5 as Exhibit 2 a true and [183] correct copy of the minutes?

A. It is.

Mr. Wild: We offer those in evidence as a true and correct copy of the minutes of American Factors of that special meeting kept in the ordinary course of business.

Mr. Atherton: No objection. We already stipulated it was.

Mr. Wild: I did not so understand. Very well.

The Court: Exhibit what? What is it you have got there?

The Clerk: P-5.

The Court: It is merely a clarification of P-5? Where does that appear in P-5?

Mr. Wild: That is Exhibit 2, your Honor.

(Testimony of Walter T. Vorfeld.)

The Court: Yes, on Exhibit 2.

Mr. Wild: Exhibit 2 on P-5.

(Witness excused.)

Mr. Wild: All right, Mr. Lowrey, will you resume the stand? That is an exhibit that records officially the meeting, the opinions of Mr. Sutro on the legal effect; and Smith, Wild, Beebe and Cades on the two other effects.

The Court: Well, this doesn't disclose what Mr. Sutro's opinion was. His opinion isn't attached to this.

Mr. Wild: No, it makes an oral report of it, though, your Honor. It says here that,

"President Bottomley stated further that this matter [184] was taken up with Mr. Oscar Sutro, attorney for the Company during the litigation, and that he feels that the whole structure of the Company was involved in the claims made by Mr. Nylen and that the litigation expenses should be paid by the Company."

That is his statement as officially recorded, showing the legal liability.

Now, I am through with the direct examination of Mr. Lowrey on this issue, your Honor.

SHERWOOD M. LOWREY

a witness in behalf of the Plaintiff, having previously been sworn, resumed and testified further as follows:

Cross-Examination

By Mr. Atherton:

Q. Mr. Lowrey, who were the members of the so-called steering committee?

A. A. W. T. Bottomley, Charles R. Hemenway, F. C. Atherton and R. A. Cooke.

Q. Did that committee hold any formal meetings?

A. If you mean formal meetings whereby records of minutes were kept, my answer is none that I know of. They met together from time to time to reach a decision among themselves and proceeded accordingly.

Q. Do you know whether any of the 23 co-defendants who were represented by this special steering committee [185] communicated to this so-called steering committee that they in any way expected to be reimbursed by American Factors for their share of the litigation expenses in the Hackfeld suit?

A. I would have no knowledge of what the conversations were between the steering committee and the other individuals unless I happened to be present or had been told about it.

Q. Do you know whether or not any of these 23 co-defendants communicated to American Factors

(Testimony of Sherwood M. Lowrey.)

any request that they be reimbursed for their share of the litigation expenses?

A. No, the whole thing was in such an upset condition that questions were all left up in the air. There was a question of getting action to defend themselves and the company. And they started when the suit was finally brought against them.

Q. You testified, I believe, that the steering committee delegated to you certain powers to make payments of small items of the expenses and that with respect to the larger items the steering committee assumed that responsibility itself and made payments.

Mr. Wild: I object to that as an unfair statement of this witness' testimony. This witness testified that the steering committee was the committee that was fully authorized under the agreement to make the determinations, and that that [186] steering committee did make determinations on all major matters.

Mr. Atherton: Your Honor, I had the reporter read back to me from the notes this morning and I took down in shorthand what he stated to me was the testimony of Mr. Lowrey, and I will read my notes verbatim which substantially the reporter said to me. He said that Mr. Lowrey testified that the steering committee delegated certain powers on the payment of the items, and that by formal action of the committee—well, I am a little garbled on my

(Testimony of Sherwood M. Lowrey.)

notes so I won't try to read them, so that I ask that my comments be stricken.

Q. Do you have any knowledge, Mr. Lowrey, as to how this so-called steering committee was authorized by these 23 co-defendants to represent them with respect to the disbursements of these litigation expenses?

A. Decisions had to be reached as to who was going to represent the group; decisions had to be reached how the case was to proceed; decisions had to be reached as to what the fees and costs of the major items were to be. And as these various subjects came up, it was discussed by that committee and decisions reached.

Q. How was the committee appointed? Do you know how the committee was actually appointed?

A. I don't remember other than that document that has been submitted. [187]

Q. What document?

A. The document that has been submitted here whereby these men were appointed to handle the things. I forget which exhibit that is. It is in this case some place here.

Mr. Wild: I can tell you. It is Exhibit 1 annexed to P-5. I think it will show Exhibit 1 annexed to P-5 as the agreement under which the defendants other than American Factors agreed to pay all the expense of the Hackfeld litigation which was incurred or approved by this steering commit-

(Testimony of Sherwood M. Lowrey.)

tee. And it is Exhibit 1. We have the original, we have the original exhibit in the courtroom.

Mr. Atherton: Off the record will you show me here something with reference to the steering committee in here?

Mr. Wild: Yes. The witness has testified——

Mr. Atherton: Never mind the witness' testimony. What does this document say?

Mr. Wild: The cost of expenses, and so forth, and so forth, and so forth; the cost and expenses are such as are set forth and "any three of them acting in the name or on behalf of all of them have already paid or incurred or shall or may hereafter pay or incur in or about or in connection with the defense . . ." And he testified that that was called the steering committee. This committee that acted is described in paragraph 2 of Exhibit 1. This witness on direct examination testified that they always called that the [188] steering committee.

Q. (By Mr. Atherton): Did the steering committee instruct you, Mr. Lowrey, with respect to refunding or repaying to the 23 co-defendants whom they represented this \$396,000?

A. No, I don't think the steering committee did at that time. I think after the action was taken by the board of directors of American Factors it was just a natural course of events where it was decided that the Factors would take and assume all expenses to take and reimburse to those 23 respondents who

(Testimony of Sherwood M. Lowrey.)

had contributed the same amount that they had paid in.

Q. Well, you don't know, then, as a matter of fact, whether any of these co-defendants ever demanded reimbursement of their share of the legal expenses?

A. No, I do not. I know no instance where anybody demanded the return of the money.

Mr. Atherton: Well, that's all.

Mr. Wild: No further questions. Just one second. No further questions of this witness. Now that closes our oral testimony. Oh, yes, I do want to ask one other question, I think, but I am not sure that it appears in the record.

Redirect Examination

By Mr. Wild:

Q. At this time all of the men in the so-called steering [189] committee are dead?

A. Correct.

Q. And of the signers, Judge Waterhouse——

A. Dead.

Q. R. A. Cooke? A. Dead.

Q. F. C. Atherton? A. Dead.

Q. F. C. Atherton again. Charles A. Atherton?

A. Dead.

Q. F. G. Lowrey? A. Alive.

Q. How old is he? A. Eighty-nine.

Q. Is he in any condition to testify in this Court at the present time? A. No.

Q. George Sherman? A. Dead.

(Testimony of Sherwood M. Lowrey.)

Q. C. H. Cooke? A. Dead.

Q. Of course Allen T. Bottomley is gone?

A. Yes.

Q. G. P. Wilcox? A. He is alive. [190]

Q. G. N. Wilcox? A. Dead.

Q. S. W. Wilcox? A. Dead.

Q. Wallace M. Alexander? A. Dead.

Q. W. M. Alexander, the same?

A. The same.

Q. E. D. Tenney A. Dead.

Q. The others are on the coast, I think, isn't that true?

A. Some are. Andrew Welch is dead. I don't know what other names appear on that corporation list.

Q. W. P. Roth? (Showing document to the witness.) A. Both alive so far as I know.

Q. But they are at present outside of the jurisdiction of the Court? A. Yes.

Mr. Wild: No further questions. Do you have oral testimony?

Mr. Atherton: No, we do not.

Mr. Wild: May we turn to the second issue in the case?

The Court: Are you through with the witness?

Mr. Wild: I am on this issue, unless your Honor wants [191] to ask questions.

The Court: No.

Mr. Wild: I did want to take up just one little

(Testimony of Sherwood M. Lowrey.)

issue about the pensions before we go into the other. But that is on a new issue.

Mr. Atherton: If you want to use the witness, use him, unless he wants to go home.

Mr. Wild: He is coming down with a cold, but he is a witness on the other issues.

Mr. Atherton: On the Henry Waterhouse?

Mr. Wild: And on the pension issue.

Mr. Atherton: Well, adjust it yourself for your convenience.

Mr. Wild: There are two additional issues in this cause. They are covered in stipulation number one, your Honor. At this time, just as a preliminary—we had an understanding that we would have the representatives of Alexander and Baldwin here when we started. I was going to offer the whole stipulation in evidence because I understood from this morning's discussion that it will probably be half past two or three.

The Court: Well, they are familiar with the stipulation, I assume.

Mr. Wild: Yes, I think so.

The Court: I don't know what knowledge they could glean or what interest they could protect by being here while you [192] read the stipulation.

Mr. Wild: Well, what I want to do, if it meets with your Honor's approval, is this: This witness stated that he was running a temperature and he believed he was coming down with a cold, and I wanted to just offer stipulation one in evidence

(Testimony of Sherwood M. Lowrey.)

now without reading it, without making any opening statement. And the Government has agreed to make no contention about that. Then I'd have this witness testify concerning the two issues that are raised there. One is the pension; the other is the Waterhouse Trust note. And we could excuse him and he can go home and go to bed.

The Court: All right. You may proceed along those lines. I understand it is agreeable to the Government.

Mr. Wild: Yes, it is agreeable. But we had promised Mr. Pratt that is one of the issues and that we would call him when we got to that issue. He was coming up here at half past two or three.

The Court: Well, your associate could step to the telephone outside and call him up, and in the meantime——

Mr. Wild: In the meantime if I can go ahead without any opening statement.

Mr. Atherton: Let me clarify something right here, your Honor, for the record. If it be that Alexander and Baldwin are going to file a separate stipulation on the Waterhouse note, it will be substantially the same as that which I [193] understand Mr. Wild is going to offer with respect to the American Factors, with a slight variance that one of the paragraphs in the A and B stipulation will show that it charged off on its books \$25,000 of the \$50,000 in 1931 and charged off the balance of the \$25,000 in the year 1932, but took the entire

(Testimony of Sherwood M. Lowrey.)

amount of \$50,000 as a deduction in its tax return for 1932. In other words, bookkeeping——

The Court: Well, they can make that showing or undergo an examination as to that after you finish this other.

Mr. Wild: Yes. May it please the Court, I offer in evidence at this time stipulation number one signed by counsel, and counsel has an objection which is of record and is contained in the stipulation, I think.

Mr. Atherton: Paragraph two and paragraph nine.

The Court: Are you able to furnish me with a copy of it?

Mr. Wild: Your Honor, I am going to give you the original, and I am going to ask that it be marked as P-10, your Honor.

The Court: Has it been filed in the case, because it was going to be offered in evidence?

The Clerk: Eleven.

(The document referred to was received in evidence as Plaintiff's P-11.)

(Testimony of Sherwood M. Lowrey.)

PLAINTIFF'S EXHIBIT P-11

In the United States District Court for the
Territory of Hawaii
Civil Action No. 419

AMERICAN FACTORS, LIMITED, A Hawai-
ian Corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix under the Will
and of the Estate of Fred H. Kanne, Collec-
tor of Internal Revenue of the United States
for the District of Hawaii,

Defendant.

SMITH, WILD, BEEBE & CADES,

(U. E. Wild)

Fourth Floor,

Bishop Trust Building,

Honolulu, T. H.

Attorneys for Plaintiff.

LELAND T. ATHERTON,

Special Assistant to the Attorney General,
Tax Division,

Department of Justice,

Washington, D. C.

Attorney for the Defendant.

STIPULATION I.

It is hereby stipulated by and between the par-

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

ties hereto through their respective attorneys that the following statements of fact shall be considered as true, and that either party may offer in evidence, oral testimony or any additional evidence, documentary or otherwise not inconsistent with the facts herein stipulated.

I.

That American Factors, Limited, the Plaintiff herein, is a corporation, incorporated under the laws of the Territory of Hawaii, having its principal office in Honolulu, City and County of Honolulu, Territory of Hawaii; that Fred H. Kanne was the Collector of Internal Revenue of the United States for the District of Hawaii, and a resident of said Honolulu at all times from on or about August 1, 1933 until his death on December 24, 1946; that Agnes M. Kanne, the duly qualified and appointed Executrix of the Will and of the Estate of Fred H. Kanne, deceased, was substituted as Defendant in the above entitled cause by order of the above entitled court on March 6, 1947.

II.

American Factors, Limited, at the end of the calendar year 1930 had a capital of \$10,000,000.00, and its books showed a surplus and undivided profits of \$5,971,049.93 or a total capital and book surplus of \$15,971,049.93. At the end of the calen-

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

dar year 1930, and during the entire calendar year 1931, American Factors, Limited, was agent for thirteen sugar plantations and other corporations located in and carrying on business in the Hawaiian Islands, which corporations, according to their books and annual reports, had a total capital of \$26,944,720.00 and a total surplus and undivided profits of \$21,411,420.24, or a total capital and surplus as of December 31, 1930 of \$48,356,140.24. On December 30, 1930, American Factors, Limited, and the companies for which it served as agent had on deposit in the banks of the Territory of Hawaii at least a total sum of \$1,741,696.24. The Defendant objects to admissibility in evidence of the aforesaid facts on the ground of their immateriality and irrelevance.

III.

The Henry Waterhouse Trust Company, Limited (hereinafter called the Waterhouse Company), was incorporated under the laws of the Territory of Hawaii on November 26, 1902, to engage in the business usual and permitted to a trust company under the laws of the territory. In addition to engaging in the usual fiduciary business common to all trust companies, it operated a plantation agency department, a real estate department, a stock and bond brokerage department, and an insurance department, and at times invested in

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

stocks and bonds to a limited extent on its own account, these various activities being permissible under the Hawaiian statutes.

IV.

In the middle of October, 1930, Waterhouse increased its capital stock from \$200,000 to \$400,000, consisting of 4,000 shares of a par value of \$100 each. The new shares were all taken by the old stockholders who paid for them in cash at par. In November the effects of the general business depression began to be felt in the Territory of Hawaii, and as a large part of the Waterhouse assets consisted of real estate and mortgages, its secretary became apprehensive that if many calls were made on its demand accounts the Company's financial condition would not be sufficiently liquid to meet its cash requirements. He discussed the situation with the treasurer and auditor of Waterhouse and then advised the management of Bishop Trust Company, Limited, hereinafter called Bishop Trust, that a sale of the stock might be arranged, suggesting a price of \$100 each or more for the shares.

V.

An Audit Report dated March 31, 1931 signed H. C. Tennent and Co. by E. J. Greaney disclosed the book value of assets of the Waterhouse Company as of February 14, 1931 to be in the amount

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

of \$4,820,090.92 and the liabilities, exclusive of capital and surplus, to be in the amount of \$4,149,437.06. This Audit Report contained the following statement:

“The Contingent Reserve (for losses) of \$680,803.15 and the Special Contingent Reserve of \$400,000.00 referred to above, are considered adequate to cover probable losses in the realization of the assets and liquidation of liabilities.”

It is also stated in the Report that the principal purpose of the Audit was to establish as accurately as possible the total assets and liabilities as of February 14, 1931, the date control of the Company passed to the Bishop Trust Company, Limited, through its acquiring all of the stock of the Waterhouse Company.

It is also stated in the Report that Exhibit A attached thereto, a copy of which is hereunto annexed and made a part hereof as Exhibit A, shows the Capital and Surplus of the Waterhouse Company as of February 14, 1931, before adjustment, the total estimated losses finally agreed upon as acceptable to the Bishop Trust Company, Limited, and the manner of arriving at the Contingent Reserve (for Losses) and the Special Contingent Reserve. In this connection, the Report states, by way of explanation of said Exhibit A, that the balance sheet shows the Profit and Loss account with a debit balance of \$400,000.00 offset against

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

the Contingent Reserve (for Losses); and that this appears as preferable for balance sheet purposes to the alternative of clearing the Capital Stock Account, and produces the same net result.

By way of explanation of Exhibit D attached to the Report, it is stated that the Special Contingent Reserve, as shown in Exhibit A above, will remain intact until actual losses written off have fully exhausted the Contingent Reserve (for Losses) of \$779,717.23; and that additional losses as determined will then be applied pro rata against the Special Contingent Reserve contributions.

VI.

Mr. A. W. T. Bottomley, president of American Factors, Limited, and of the Bishop First National Bank of Honolulu and vice-president of the Bishop Trust Company, Limited, called a conference of the heads of the four Hawaiian sugar agencies, the president of the Bank of Hawaii, Limited, the president of the Hawaiian Trust Company, Limited, and two members of the finance committee of the Bishop Trust Company, Limited, to present to them the financial condition of the Waterhouse Company and discuss the feasibility of making some plan to prevent the Waterhouse Company from being forced into liquidation.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

VII.

The Waterhouse Company was conducting business as usual but was encountering some financial difficulties; economic conditions were not clear, and after the investigation, the executives of the Bishop Trust Company, Limited, wished to look further into the matter before acting. After February 1, 1931, the Bishop Trust Company, Limited, advised the Waterhouse Company shareholders that it would not pay cash for their shares as had previously been suggested. On Saturday, February 14, 1931, Mr. W. F. Frear, president of the Bishop Trust Company, Limited, at a meeting of the board of directors of that company made a statement which was recorded on the minutes as follows:

“This is a special meeting called to consider a proposition to take over the Henry Waterhouse Trust Co., Ltd. At first it was a proposition to purchase the stock of that company, somewhat as we purchased the stock of the Pacific Trust Co., but as a result of investigation, it changed largely to a salvage proposition.

“The plan now is for our Company to acquire all the stock of the Waterhouse Trust Co. without cost; for Mr. and Mrs. R. W. Shingle and Mr. A. N. Campbell, in settlement of their indebtedness to the Company, to pay into it \$535,000.00 and to convey to its order their respective 18% and

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

10% undivided interests in certain land, fish ponds and fishery at Kalihi, the same to be sold for \$87,000.00 and the proceeds, with \$13,000.00 additional contributed by the Bishop Trust Co., to make up an even \$100,000.00, to be paid into the Waterhouse Trust Co., making in all \$635,000.00 thus paid in. In addition, a number of corporations and individuals are to contribute various sums aggregating \$400,000.00, thus making altogether \$1,035,000.00 of cash to be paid into the Waterhouse Trust Co. The Bishop Trust Co. is to pay such amount, if any, as may be required in addition to enable the Waterhouse Trust Company to meet its liabilities, but it is hoped that no such contribution will be required. That, however, remains to be seen.

“The Bishop Trust Co. is to take over, without other cost, the business of the Waterhouse Trust Co., other than the assets and liabilities, and to operate such business at its own expense and for its own benefit. This will include the trusts, executorships, agencies, insurance, safe deposit business, etc., with the necessary furniture, equipment and supplies therefor. It is hoped also that the Bishop Trust Co., will profit through making new contacts. The stock and bond and real estate departments will probably be discontinued.

“The assets and liabilities of the Waterhouse Trust Co. are to be gradually liquidated by applying the assets to the liabilities, together with the

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

expenses of liquidation, including \$1,000.00 a month to be paid to the Bishop Trust Co. for supervision.

“In final settlement, if there is an excess of assets over liabilities, it is to be applied, first, to the reimbursement of the amount, if any, that may be contributed by the Bishop Trust Co. in addition to the \$1,035,000.00, and, secondly, pro rata to the contributors of the \$400,000.00 with simple interest at 4%, and, thirdly, the balance, if any, to go to the Bishop Trust Co.

“There are three objects: First, to prevent the failure of such a company as the Waterhouse Trust Co., with the consequent general disastrous effects; secondly, to prevent loss on the part of many who have entrusted their money to the Company for investment and who can ill afford the loss; and, thirdly, to enable the Bishop Trust Co. to acquire new business. These three objects naturally appeal with different degrees of force to different groups of contributors.”

The plan, as outlined, was approved by the Board of directors of the Bishop Trust Company, Limited, at that meeting. The transactions mentioned in the second paragraph of Mr. Frear's statement, *supra*, were duly performed within a few days after February 14, 1931.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

VIII.

Prior to the consummation of the transactions hereinbefore mentioned, the following individuals and corporations promised to pay to the Waterhouse Company, upon consummation of the proposed plan, the sums of money set opposite their names, to wit:

Name of Contributor	Amount Paid
The Bishop Company, Limited	\$100,000
American Factors, Limited	50,000
Alexander & Baldwin, Limited	50,000
Castle & Cooke, Limited	50,000
W. R. Castle	50,000
Beatrice Castle Newcomb	50,000
Bank of Hawaii	25,000
Hawaiian Trust Company, Limited . . .	25,000
Total	\$400,000

IX.

Annexed hereto as Exhibit B and made a part hereof is an excerpt from the minutes of the meeting of the Board of Directors of American Factors, Limited, held on March 2, 1931, authorizing the aforesaid payment of \$50,000 to the Waterhouse Company. There are also annexed hereto and made a part hereof as Exhibits C, D, E, F and G, excerpts from the minutes of the Directors' meetings of the

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

corporations who made their respective payments to the aforesaid \$400,000 fund of the Waterhouse Company.

X.

The plan of reorganization of the Waterhouse Company was carried out as outlined above, and the individuals and corporations whose names appear in the preceding paragraph of this stipulation actually paid into the Waterhouse Company the amounts of money stated opposite their respective names upon the provisions concerning the repayment thereof as more particularly stated in the letters to Plaintiff dated February 21, 1931, and February 24, 1931, copies of which are attached hereto and made a part hereof as Exhibits H and I, respectively. Letters identical in form as Exhibits H and I were addressed to each of the individuals and corporations that made payments to the Waterhouse Company aggregating \$400,000, and said letters were duly received by each such individual and corporation.

XI.

Attached hereto and made a part hereof for all purposes and marked Exhibit J is a true copy of a promissory note executed and delivered by the Waterhouse Company to Plaintiff in the principal sum of \$50,000.00, being the note referred to in said letter, Exhibit H. Notes identical in form were executed and delivered by the Waterhouse Company

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

to each such other corporation and to each such individual, which said notes were in each instance for the principal sum of money as stated opposite the name of the respective individuals and corporations hereinbefore stated.

XII.

The actual owners of the capital stock of the Waterhouse Company on February 14, 1931, shortly prior to the transfer of the stock of that company to the Bishop Trust Company, Limited, were as follows:

Stockholder	Shares	Par Value
A. N. Campbell	1,235	\$123,500.00
R. W. Shingle	1,235	123,500.00
A. L. Castle	700	70,000.00
J. K. Clarke	480	48,000.00
Harriet E. Wight	100	10,000.00
C. L. Wight	100	10,000.00
Marietta Withington	50	5,000.00
Arthur Withington	50	5,000.00
Estate of E. M. Lewis	50	5,000.00
<hr/>		<hr/>
Total	4,000	\$400,000.00

XIII.

The four stockholders whose names appear first on the above list, namely, A. N. Campbell, R. W. Shingle, A. L. Castle and J. K. Clarke, were di-

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

rectors of the Waterhouse Company. Mr. W. R. Castle, father of A. L. Castle, purchased from the stockholders, other than Messrs. Campbell, Shingle and Clarke, their shares of the capital stock of the Waterhouse Company as follows:

Stockholders	Shares	Par Value
Harriet E. Wight	100	\$10,000.00
Charles L. Wight	100	10,000.00
Marietta Withington	50	5,000.00
Arthur Withington	50	5,000.00
Estate of E. M. Lewis	50	5,000.00
<hr/>		<hr/>
Total	350	\$35,000.00

Thus, on February 14, 1931, the following persons were the stockholders of the Waterhouse Company, and they were the owners of the number of shares shown opposite their names, to wit:

Stockholder	Shares	Par Value
A. N. Campbell	1,235	\$123,500.00
R. W. Shingle	1,235	123,500.00
A. L. Castle	700	70,000.00
W. R. Castle	350	35,000.00
J. K. Clarke	480	48,000.00
<hr/>		<hr/>
Total	4,000	\$400,000.00

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

XIV.

The \$400,000 par value of capital stock of the Waterhouse Company was transferred by the aforesaid stockholders to the Bishop Trust Company, Limited, as of February 14, 1931, and the cash balances, properties, stocks and bonds, accounts, books and records of the Waterhouse Company came under the management and control of the new stockholder, the Bishop Trust Company, Limited. New officers and directors were elected, a finance committee, comprised of officers and directors, and an advisory committee comprised of representatives of the \$400,000 noteholders, were appointed, and work was immediately commenced on the liquidation of the Waterhouse Company.

XV.

There is annexed hereto as Exhibit K and made a part hereof condensed balance sheets of the Waterhouse Company as at February 14, 1931, before and after the reorganization.

XVI.

On May 29, 1931, the vice-president and manager of the Bishop Trust Company, Limited, who was also a director of the Waterhouse Company, stated to the board of directors of the Bishop Trust Company, Limited, that the operation of the Waterhouse Company business was causing a monthly

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

loss "as it is in the nature of a receivership." He added the belief that "the bulk of the work in straightening out the affairs of the company will be accomplished within a year or two." At a meeting of June 26, 1931, he advised the board of directors of the Bishop Trust Company, Limited, that:

"* * * he had made a recommendation to the Bishop Trust Company of a transfer of all of the work of the Waterhouse Trust Company directly to the Bishop Trust Company, with the exception of the collection agency end of the business."

At the same time he stated his belief that the Bishop Trust Company, Limited, would suffer no loss if business should again become normal. Thereupon the Bishop Trust Company, Limited, took over some of the Waterhouse Company business, but the Waterhouse Company continued to do some business until it, the Guardian Trust Company, Limited, and the Pacific Trust Company, Limited, were formally merged into the Bishop Trust Company, Limited, on December 30, 1933 as hereinafter set forth.

XVII.

There is annexed hereto as Exhibit L and made a part hereof condensed balance sheets of the Waterhouse Company as at December 31, 1931, and December 31, 1932.

XVIII.

The advisory committee referred to in Exhibit

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

I was composed of prominent business and professional men who represented the aforesaid note holders who had made payments into the aforesaid \$400,000.00 fund. The original committee consisted of:

1. A. W. T. Bottomley (now deceased) whose alternates were S. M. Lowrey, who was then Plaintiff's treasurer, and H. A. Walker who is now president of the Plaintiff.

2. C. H. Cooke, then president of the Bank of Hawaii, Limited, whose alternates were R. McCriston, now a vice-president of the Bank of Hawaii, Limited, G. G. Fuller, now retired, who was a vice-president of the Bank of Hawaii until his retirement, and E. W. Carden who is now president of the Bank of Hawaii.

3. A. L. Castle, an attorney at law, at present a partner in the firm of Robertson, Castle & Anthony, whose alternates were F. C. Atherton (now deceased) then the president of Castle & Cooke, Limited, and A. G. Budge, now president of Castle & Cooke, Limited.

The composition of the advisory committee changed from time to time thereafter and among the other persons who attended meetings as a member of the committee was: James L. Cockburn who was then the executive vice-president of Bishop & Company, Limited.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

This committee met frequently with the finance committee of the Waterhouse Company and passed upon all matters of importance affecting that Company and particularly those matters tending to affect the amount of reimbursement, if any, ultimately to be made to the special note holders. It advised with Bishop Trust Company, Limited, and its members were consulted from time to time by the Plaintiff and other special note holders.

XIX.

Under date of July 18, 1932, the Waterhouse Company, over the signature of M. B. Henshaw, vice-president, dispatched to the Plaintiff a letter, a true copy of which is annexed hereto as Exhibit M and made a part hereof. The defendant objects to the admissibility in evidence of Exhibit M on the following grounds, viz: (a) that the statements made therein are immaterial to any issue involved herein; and (b) that its admission in evidence for the purpose of proving the truth and accuracy of the statements made therein concerning the reappraisal of the assets and liabilities of the Waterhouse Co., and the competency and accuracy of such reappraisal would constitute a violation of the hearsay rule, and such evidence is also incompetent. Letters identical in form to Exhibit M were dispatched by the Waterhouse Company to the other noteholders and received by them. The advisory

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

committee was not abrogated but continued to function as usual during the balance of the year 1932 and the year 1933.

XX.

During 1933 for the stated purpose of simplifying its financial structure and effecting economies, Bishop Trust Company, Limited, decided to effect a merger. Attached hereto, made a part hereof for every purpose, and marked Exhibit N is a copy of a letter dated December 19, 1933, sent by the Waterhouse Company to The Bishop Company, Limited. Letters identical in form with Exhibit N were sent to and received by each of the aforesaid Waterhouse Company noteholders.

XXI.

On December 21, 1933, a meeting of the said Waterhouse Company noteholders was held at which the holders of \$300,000 out of a total of \$400,000 of the notes outstanding were represented as follows:

Noteholder	Amount of Note Held
American Factors, Ltd., S. M. Lowrey, representative	\$ 50,000
Alexander & Baldwin, Ltd., C. R. Linden, representative	50,000
The Bishop Company, Ltd., George P. Rea, representative	100,000

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

W. R. Castle, Alfred L. Castle, representative	50,000
Alfred L. Castle, as executor under will of Beatrice Castle Newcomb, deceased, Alfred L. Castle, representative	50,000
Total	<hr/> \$300,000

The noteholders who were not represented at this meeting were:

Noteholder	Amount of Note
Castle & Cooke, Ltd.	\$ 50,000
Bank of Hawaii	25,000
Hawaiian Trust Co., Ltd.	25,000
Total	<hr/> \$100,000

Present by invitation were Messrs. C. F. Weeber and M. B. Henshaw. The minutes of the meeting record that—

“Mr. Henshaw stated that the purpose of the meeting was to consider the letters dated December 19 which had been sent out to all of the corporations and/or individuals who had loaned money to Henry Waterhouse Trust Co., Ltd., in February, 1931.” and after some discussion it was the unanimous opinion of those present that proposal No. 1 as set forth in the letters dated December 19, 1933 (Exhibit N), be approved.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

The minutes of that meeting also record that—

“Mr. Linden suggested that after the proposed merger the Advisory Committee be continued, at least until such time as the question of whether the notes held by the underwriters become a loss in the year 1932, is definitely settled. It was the consensus of opinion that this suggestion be followed.”

XXII.

Following the merger aforesaid, on December 30, 1933, the Bishop Trust Company, Limited, for the purpose of accounting to the aforesaid noteholders kept separate accounting records referred to as the “Waterhouse Section,” of the Waterhouse Company assets acquired and the liabilities assumed in respect thereto. Among the records so kept, a special account designated “Notes Payable—Underwriters H W T—New” was set up to cover the \$400,000 paid in by the aforesaid noteholders and the charges against it. This account at December 30, 1933, showed a credit balance of \$400,000.

XXIII.

The following is a statement of book value of the Waterhouse Company assets, exclusive of cash, on the indicated dates, actual losses sustained on liquidation to the indicated dates, set up on the latter's books, and the estimated losses on liquidation arrived at by a group of officers of the Bishop Trust Company, Limited:

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

	Book value of assets exclusive of cash	Actual losses sustained on liquidation	Estimated loss on liquidation
Feb. 14, 1931	\$4,275,543.05	\$ —————	\$1,080,803.15
Dec. 31, 1931	3,697,746.38	324,913.77	—————
1932	2,993,234.31	410,345.80	—————
1933	2,965,675.99	571,482.80	*936,352.98

XXIV.

Plaintiff's books of account were kept on the accrual basis of accounting, and, during the calendar years 1924-1932, inclusive, they were so kept, and its Federal Income Tax returns for those years were made on that basis of accounting. In the calendar year 1932, Plaintiff charged off on its books of account the face amount of the aforesaid \$50,000.00 Waterhouse Trust Company promissory note which was given to the Plaintiff in the year 1931, pursuant to the actual method of charging off bad debts which the plaintiff used in that taxable year and all prior taxable years for income tax purposes.

XXV.

In its Federal Income Tax return for the taxable year 1932, at item 20 on page 1 thereof, the taxpayer took as a bad debt deduction the entire

*Estimate made by Bishop Trust Company's comptroller of the losses that would be sustained on the liquidation of the remaining assets.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

amount of \$50,000 paid by it to the Waterhouse Company in 1931. The Commissioner of Internal Revenue determined that the \$50,000 paid to Henry Waterhouse Trust Company was not deductible as a bad debt deduction for the year 1932.

XXVI.

During the calendar year 1932 taxpayer paid the total sum of \$4,063.33 to the following individuals in the amounts stated opposite their names, to wit:

Payee	Amount Paid
Mrs. R. C. Walker	\$1,200.00
Minor children of John Frank, deceased	300.00
Minor children of W. Zablan, deceased.	240.00
Mrs. Wm. Searby	1,800.00
Mrs. Luddecke	523.33
	<hr/>
Total	\$4,063.33

The above payments were to widows and minor children of former employees of plaintiff.

In its federal income tax return for the taxable year 1932 taxpayer deducted the above amounts as ordinary and necessary expenses in computing its taxable net income. The Commissioner of Internal Revenue in his first deficiency letter allowed the

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)
deduction and in his second deficiency letter dis-
allowed the same.

SMITH, WILD, BEEBE
& CADES,

/s/ U. E. WILD,

/s/ MILTON CADES,

Counsel for Plaintiff.

/s/ LELAND T. ATHERTON,
Special Assistant to the Attorney General, Tax
Division, Department of Justice,
Counsel for Defendant.

/s/ RAY J. O'BRIEN,
United States Attorney for the District of Hawaii,
Counsel for Defendant.

EXHIBIT A

Henry Waterhouse Trust Co., Ltd.
Analysis of Capital Adjustments for Reorganization

February 14th, 1931

Capital and Surplus Before Adjustment:

Capital Stock		\$400,000.00#
Surplus Earned	\$ 200,000.00	
Profit and Loss.....	158,575.93#	
Special Reserve	15,000.00	
Sundry Accounts Special.....	1,141.30	
Reserve for Taxes	5,000.00	
	<hr/>	
Total Surplus		379,717.23
		<hr/>
Total Capital and Surplus transferred to Reserve.....		\$779,717.23
		<hr/>

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

Shingle and Campbell

Accounts Net	\$ 733,914.08
Estimated Losses	1,080,803.15

Total (Basis for Reorganization) ..	\$1,814,717.23
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Payments:

R. W. Shingle	\$ 492,137.23
A. N. Campbell.....	142,862.77

Total Direct Payments	\$ 635,000.00
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Bishop First Nat'l

Bank	\$ 100,000.00
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Bank of Hawaii, Ltd.	25,000.00
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Hawaiian Trust Co., Ltd.	25,000.00
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American Factors, Ltd.	50,000.00
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Alexander & Baldwin, Ltd.	50,000.00
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Castle & Cooke, Ltd...	50,000.00
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W. R. Castle	50,000.00
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Beatrice Castle Newcomb	50,000.00
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Total Contingent Payments	\$ 400,000.00
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Total Payments	\$1,035,000.00
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Balance of estimated losses

to apply against reserve

created by transfer from Surplus.....	\$779,717.23
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For balance sheet purposes a debit balance of \$400,000.00 is set up in the Profit and Loss Account to offset the Capital Stock Account which stands with a credit balance of \$400,000.00.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT B

Excerpt From Minutes of Special Meeting of Board
of Directors of American Factors, Ltd., Held
March 2nd, 1931

“President Bottomley informed the Directors of the circumstances surrounding the taking over of the business of the Henry Waterhouse Trust Co., Ltd. by the Bishop Trust Co., Ltd. and stated that, following consultation with such of the Directors as he was able to reach in the time available, it was deemed advisable in the interests of the business community as a whole that this Company join with others in certain financing required for this transaction. President Bottomley stated further that a loan had been made to the Henry Waterhouse Trust Co., Ltd. in the amount of \$50,000.00 against its note dated February 21st, 1931, bearing 4% interest, and repayable when and if in the opinion of the officers of the Bishop Trust Co., Ltd. the sound assets of the Henry Waterhouse Trust Co., Ltd. are equal to its liabilities and asked the approval of the Directors of his action in agreeing to make this loan. On motion of Mr. Atherton, seconded by Mr. Dillingham and carried unanimously, the action of President Bottomley in authorizing the above-mentioned loan was ratified and approved.”

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT C

Excerpt From Minutes of Directors' Meeting of
Alexander and Baldwin, Limited, Held February 25, 1931

Loan to Henry Waterhouse Trust Company, Ltd.

On motion by Mr. Galt, seconded by Dr. Dean, the loan of \$50,000.00 to the Henry Waterhouse Trust Company Limited, which had been made with the informal approval of a majority of the Board, was also formally ratified and confirmed.

EXHIBIT D

Excerpt From Minutes of Directors' Meeting of
Hawaiian Trust Company, Limited, Held February 26, 1931

Loan to Henry Waterhouse Trust Company, Ltd.

President Galt stated that he had been reliably informed that Henry Waterhouse Trust Company, Ltd. had become seriously involved financially, and that our company and others had rendered assistance; our company to the extent of a \$25,000.00 loan, in order to protect the four or five hundred depositors of the Henry Waterhouse Trust Company.

Director Hemenway moved that this loan of \$25,000.00 to Henry Waterhouse Trust Company, Limited, be approved. The motion was seconded by Director McInerny and carried unanimously.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT E

Excerpt From Minutes of Directors' Meeting of
Castle and Cooke, Limited, Held March 5, 1931

President F. C. Atherton referred to the letter circulated among the Directors under date of February 24, 1931 (copy appended hereto) recommending that the sum of \$50,000.00 be loaned to the Henry Waterhouse Trust Company, Limited, to prevent that company from going into bankruptcy and thus causing widespread financial losses throughout the community. Although this loan had been informally approved by the Directors, in view of the importance of the subject it would seem advisable to take formal action at this time approving and ratifying the original action and also placing the foregoing letter in the records of the Company.

It was moved by Director Atherton Richards and seconded by Director H. K. L. Castle that the Directors hereby formally ratify and approve their action taken informally under date of February 24, 1931, authorizing a loan of \$50,000.00 to the Henry Waterhouse Trust Company, Limited, in conjunction with other loans to the said Company by other business houses of this city, and that the letter of President F. C. Atherton to the Directors referred to above be placed on record in the Minute Book; that in view of the rumors which

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

are in circulation in the community regarding the financial condition of the said Henry Waterhouse Trust Company, Limited, the proper officers of this company are hereby requested to ask the Territorial Government to make such review of the transactions and records of the Henry Waterhouse Trust Company, Limited, as is deemed appropriate and desirable.

Carried.

EXHIBIT F

Excerpt From Minutes of Directors' Meeting of
the Bishop Company, Limited, Held March 12,
1931

“It was moved by Director John Waterhouse, seconded by Director Ellis and unanimously carried

“That the loan to Henry Waterhouse Trust Company, Limited, of \$100,000.00 at four per cent, on conditional note of the company, be and the same hereby is approved and confirmed and that copies of the note and letters as submitted outlining terms and conditions of repayment of the note be incorporated in these minutes.”

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT G

Excerpt From Minutes of Directors' Meeting of
Bank of Hawaii Held March 12, 1931

“The President read * * * Report of the Advisory Committee of March 11, 1931, in which no comments were made on the loans granted from February 15th to 28th, 1931. The Committee called the attention of the Directors to the Loan of \$25,000.00 to the Henry Waterhouse Trust Company, Limited, at a special rate of interest—4%.”

EXHIBIT H

Henry Waterhouse Trust Company
Limited

P. O. Box 3410
Honolulu, Hawaii

February 21, 1931.

American Factors, Ltd.,
Honolulu, T. H.

Gentlemen:

We outline as follows the plan in regard to the Henry Waterhouse Trust Company, Limited.

1. The Bishop Trust Co., Ltd., has acquired all of the capital stock of the Henry Waterhouse Trust Co., Ltd.

2. In settlement of their indebtedness to the Henry Waterhouse Trust Co., Ltd., R. W. Shingle

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

and wife have paid into that Company \$435,000.00; A. N. Campbell has paid into it \$100,000.00; and R. W. Shingle and A. N. Campbell are to convey to the Company or to its order their respective 18% and 10% undivided interests in certain land, fish ponds and fishery at and near Mokauea, Kalihi-kai, Honolulu, the same to be sold and the proceeds thereof, plus such additional sum (to be contributed by Bishop Trust Co., Ltd.) as shall be necessary to make a total of \$100,000.00, to be paid to the Henry Waterhouse Trust Co., Ltd.

3. The following corporations and individuals have contributed or are to contribute the following sums to the Henry Waterhouse Trust Co., Ltd.; The Bishop Co., Ltd., \$100,000.00; American Factors, Ltd., Alexander & Baldwin, Ltd., Castle & Cooke, Ltd., W. R. Castle and Beatrice Castle Newcomb each \$50,000.00; and the Bank of Hawaii, Ltd., and the Hawaiian Trust Co., Ltd., each \$25,000.00. For the amounts of these contributions notes of the Henry Waterhouse Trust Co., Ltd., of even date herewith, bearing simple interest at the rate of four per cent (4%) per annum, have been or will be given to the respective contributors, payable, however, only as provided in paragraph 8.

4. The Bishop Trust Co., Ltd., will ultimately contribute such amount, if any, over the above sums aggregating \$1,035,000.00, as may be required to

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

liquidate the liabilities (other than the sums or notes mentioned in paragraph 3) of the Henry Waterhouse Trust Co., Ltd.

5. The Bishop Trust Co., Ltd., will take over, own and operate at its own expense and for its own benefit, in its own name or in the name of the Henry Waterhouse Trust Co., Ltd., the business (with such of the furniture, equipment and supplies as shall be required therefor) other than the assets subject to the liabilities (referred to in paragraph 6) of the Henry Waterhouse Trust Co., Ltd. Any of the business so taken over by the Bishop Trust Co., Ltd., may by it be discontinued, sold or merged with its other business.

6. The assets and liabilities of the Henry Waterhouse Trust Co., Ltd., will gradually be liquidated by applying the assets or their proceeds and the income therefrom to (a) the expenses involved in such liquidation (such as salaries, taxes, rent, insurance, legal, auditing, bank examiner, postage, cables, books, stationery, etc.); (b) \$1,000.00 per month to the Bishop Trust Co., Ltd., for overhead or supervision; (c) interest payable; (d) indebtedness; and (e) other liabilities, if any. The assets shall be deemed to include cash on hand, bank deposits, notes and accounts receivable, stocks and bonds, stock exchange seat, and furniture, equipment and supplies (except as otherwise provided

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

in paragraph 5) owned by the Henry Waterhouse Trust Co., Ltd., at the close of business on February 14, 1931, and the sums since paid or to be paid in as set forth in paragraphs 2, 3 and 4; the liabilities shall be deemed to include all liabilities of the Company as of that date; and liabilities subsequently incurred in connection with the liquidation; the expenses of operation shall be deemed to include, besides other items, the cost of investigation by accountants preliminary to the reorganization, the cost of an audit of the Company's affairs and of the set-up of the accounting system at the outset by accountants, a proper pro rata of salaries of officers and employees of the Bishop Trust Co., Ltd., transferred temporarily for the reorganization, rehabilitation and readjustment of the affairs of the Henry Waterhouse Trust Co., Ltd., at the outset and a proper pro rata of the salaries of officers and employees of the Henry Waterhouse Trust Co., Ltd., so long as their services are rendered in part in connection with the liquidation and in part in connection with the business taken over by the Bishop Trust Co., Ltd. It is proposed, for convenience, efficiency and economy, to transfer the various branches of the business to the Bishop Trust Building as soon as the circumstances warrant.

7. In final settlement, the excess, if any, of the assets as defined in paragraph 6 or their proceeds

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

and the income therefrom over the payments specified in paragraph 6 is to be applied, so far as it will go, in the following order of priority: First, to reimbursing the Bishop Trust Co., Ltd., for such amount, if any, without interest as may be contributed by it under paragraph 4 above; secondly, to paying pro rata, principal and interest, the notes mentioned in paragraph 3, and thirdly, the balance, if any, of such excess to be paid to the Bishop Trust Co., Ltd.

8. The Henry Waterhouse Trust Co., Ltd., may from time to time borrow money (from the Bishop Trust Co., Ltd., and/or others) to meet its requirements in connection with the liquidation and repay the same with interest. The notes (principal and interest) mentioned in paragraph 3 shall be payable only if and to the extent that there shall be an excess of assets available therefor in final settlement after the payments specified in paragraph 6 and the reimbursement of the Bishop Trust Co., Ltd., provided for in subdivision First of paragraph 7. The books of the Henry Waterhouse Trust Co., Ltd., shall be closed at the end of each calendar half year and a financial statement for such half year shall thereupon be furnished to each of the contributors named in paragraph 3. Such contrib-

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

utors shall have the right to inspect the books of the Company at all reasonable times.

Very truly yours,

HENRY WATERHOUSE
TRUST CO., LIMITED,

By /s/ W. F. FREAR,
Its President.

By /s/ W. A. WHITE,
Its Treasurer.

Approved:

BISHOP TRUST COMPANY,
LIMITED,

By /s/ W. F. FREAR,
Its President.

By /s/ E. W. SUTTON,
Its Treasurer.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT I

Henry Waterhouse Trust Company,
Limited

P. O. Box 3410
Honolulu, Hawaii

February 24, 1931

American Factors, Ltd.,
Honolulu, T. H.

Gentlemen:

Supplementing our letter of the 21st instant in regard to the Henry Waterhouse Trust Co., Ltd.:

1. There is a Finance Committee, consisting at present of M. B. Henshaw, J. L. Cockburn and E. W. Sutton, for frequent consultation on numerous matters, including many that naturally it would be impracticable to bring before the Advisory Committee referred to in the next paragraph.

2. There will be an Advisory Committee for passing upon various matters of importance, particularly those tending to affect the amount of reimbursement, if any, ultimately to be made to the contributors mentioned in paragraph 3 of the letter above referred to—such matters as sales of stocks and bonds owned by the Company, compromises of claims by or against the Company, etc. This Committee will consist for the present of

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

A. W. T. Bottomley, C. H. Cooke and A. L. Castle, with alternates as follows to act in their several respective places when they cannot act: H. A. Walker and S. M. Lowrey, alternates to A. W. T. Bottomley; R. McCorriston and E. W. Carden, alternates to C. H. Cooke; F. C. Atherton and A. G. Budge, alternates to A. L. Castle.

Very truly yours,

HENRY WATERHOUSE
TRUST COMPANY,
LIMITED,

By /s/ W. F. FREAR,
Its President.

By /s/ H. A. WHITE,
Its Treasurer.

Approved:

BISHOP TRUST COMPANY,
LIMITED,

By /s/ W. F. FREAR,
Its President.

By /s/ E. W. SUTTON,
Its Treasurer.

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT J

(\$50,000.00)

February 21, 1931

For value received, the Henry Waterhouse Trust Company, Limited, promises to pay to American Factors, Limited, Fifty Thousand Dollars (\$50,000.00), with interest thereon from date at the rate of four per cent (4%) per annum, payment of principal and interest to be made only when, if and to the extent that there shall be funds available therefor as set forth in letter of this date from the payor to the payee.

HENRY WATERHOUSE
TRUST COMPANY,
LIMITED,

By /s/ W. F. FREAR,
Its President.

By /s/ H. A. WHITE,
Its Treasurer.

[Seal]

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT K

Henry Waterhouse Trust Company Balance Sheets

	As at 2/14/31 (Before Reor- ganization)	As at 2/14/31 (After Reor- ganization)
Assets:		
Cash	\$ 9,547.87	\$1,044,547.87
Investments	605,181.47	605,181.47
Receivables	77,184.34	77,184.34
Trust and agency accounts (Shingle & Campbell).....	733,914.08	.....
Other trust & agency acct.....	1,439,567.36	1,439,567.36
Loans	1,978,492.73	1,978,492.73
Other assets	75,117.15	75,117.15
Stocks and bonds.....	.....	.....
Stocks in subsidiaries.....	.....	.....
Advances to subsidiaries .....	.....	.....
Real estate for sale .....	.....	.....
Expense in suspense.....	.....	.....
Profit and loss—Special.....	.....	400,000.00
	<u>\$4,919,005.00</u>	<u>\$5,620,090.92</u>

Liabilities:

Overdrafts balances due Brokers, etc.....	\$ 457,545.90	\$ 457,545.90
Notes payable	223,100.00	223,100.00
Trust & agency accounts.....	2,978,515.16	2,978,515.16
Loans pledged to clients.....	490,276.00	490,276.00
Merchandise accounts .....	.....	.....
Notes payable—affiliated Co. ....	.....	.....
Income in suspense.....	.....	.....
P. & L. Acct.—operating deficit 2/14/31 .....	.....	(10,149.29)
P. & L. Acct.—operating deficit subsequent to 2/14/31 .....	.....	.....
Surplus & surplus reserves.....	369,567.94	.....
Reserve for losses .....	.....	680,803.15
Contingent reserve—underwriters .....	.....	400,000.00
Capital stock	400,000.00	400,000.00
	<u>\$4,919,005.00</u>	<u>\$5,620,090.92</u>

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT L

Henry Waterhouse Trust Company Balance Sheets

Assets:	As at 12/31/31	As at 12/31/32
Cash	\$ 29,700.69	\$ 14,639.50
Investments .....	.....	.....
Receivables .....	.....	15,214.69
Trust and agency accounts (Shingle & Campbell).....	.....	.....
Other trust & agency accts.....	383,460.67	299,565.32
Loans	2,247,844.14	1,624,740.12
Other assets	17,434.16	17,326.66
Stocks and bonds	251,220.65	267,122.42
Stocks in subsidiaries.....	303,704.16	303,704.16
Advances to subsidiaries.....	324,382.60	314,787.92
Real estate for sale.....	169,700.00	233,273.02
Expense in suspense.....	.....	17,500.00
Profit and Loss—Special.....	400,000.00	400,000.00
	<u>\$4,127,447.07</u>	<u>\$3,507,873.81</u>

Liabilities:

Overdrafts balances due Brokers, etc.....	\$ 79,578.59	46,648.10
Notes payable	376,557.98	674,190.88
Trust & agency accounts.....	1,834,540.86	1,068,907.28
Loans pledged to clients.....	198,000.00	132,128.00
Merchandise accounts	1,252.11	.....
Notes payable—affiliated Co.	550,000.00	602,500.00
Income in suspense.....	.....	2,417.13
P. & L. Acct.—operating deficit 2/14/31	(10,149.29)	(10,149.29)
P. & L. Acct.—operating deficit subsequent to 2/14/31.....	(58,526.56)	(80,062.56)
Surplus & surplus reserves.....	.....	.....
Reserve for losses	356,193.38	271,294.27
Contingent reserve—Underwriters	400,000.00	400,000.00
Capital stock	400,000.00	400,000.00
	<u>\$4,127,447.07</u>	<u>\$3,507,873.81</u>

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT M

Henry Waterhouse Trust Company
Limited

P. O. Box 3410
Honolulu, Hawaii

July 18, 1932

American Factors, Ltd.
Honolulu, T. H.

Gentlemen:

Under date of February 21, 1931, you loaned to this Company the sum of \$50,000.00 for which we gave you our promissory note payable upon the terms and conditions set forth in our letter to you of like date.

On February 24, 1931, it was agreed that there should be an Advisory Committee representing your Company and the other corporations and/or individuals (hereinafter called the "Underwriters") who loaned to this Company an aggregate of \$400,000.00,—the duties of said Committee being to pass upon various matters of importance, particularly those which might affect the amount of reimbursement ultimately to be made to said Underwriters.

Early in 1932 the Advisory and Finance Committees of this Company decided that it was advisable to reappraise all of its assets; an exhaustive reappraisal disclosed that its liabilities, other

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

than those to the Underwriters and Stockholders, exceeded the value of its assets by a very considerable amount. Since that time market conditions have become worse. We are now quite confident, and accordingly advise you, that in our opinion the promissory note of \$50,000.00 above referred to is of no value whatever. Despite the worthlessness of the note it remains an apparent liability of this Company and operates as a hindrance to its speedy liquidation, especially as so long as it remains on our books the Advisory Committee will have to be continued. Hence we suggest that you concede the worthlessness of the note by formally authorizing this Company to consider that it is no longer an obligation. We have been informed that, under these circumstances, you may claim said bad debt as a deduction in your income tax return for 1932, provided you write it off your books during said year.

If the foregoing suggestion is approved by all of the "Underwriters" it will no longer be necessary to have an Advisory Committee and we therefore ask that such Committee be abrogated.

Very truly yours,

HENRY WATERHOUSE

TRUST CO., LTD.,

/s/ M. B. HENSHAW,

Vice-President.

MBH:M

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

EXHIBIT M

December 19, 1933

The Bishop Company, Ltd.,
Honolulu, T. H.

Attention: Mr. George P. Rea,
Executive Vice-President.

Gentlemen:

It is planned to merge the Guardian, Pacific and Henry Waterhouse trust companies into the Bishop Trust Co., Ltd., for purposes of economy and simplicity of financial structure, under the provisions of Act 169 of the Session Laws of 1931. This plan has been approved unanimously at meetings of the directors of the four companies, and will be submitted to their stockholders respectively at meetings to be held on the 28th instant with a view to completing the merger by the end of the year.

Referring to the notes given to you and others by the Henry Waterhouse Trust Co., Ltd., when that company was taken over by the Bishop Trust Co., Ltd., the payment of which was contingent as therein set forth, and referring also to the letters of the Henry Waterhouse Trust Co., Ltd., to you and such others accompanying those notes and setting forth the agreement entered into at that time;

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

It is proposed (1), if the holders of said notes so desire, after the merger, to keep earmarked the assets and liabilities of the Henry Waterhouse Trust Co., Ltd., as well as accurate accounts of all amounts which the Bishop Trust Co., Ltd., shall have theretofore contributed, advanced or loaned to the Henry Waterhouse Trust Co., Ltd., or which it may thereafter contribute or advance toward meeting such liabilities, so as to protect the rights of such holders in case by any possibility there should ultimately be an excess of such assets over such liabilities plus or including such contributions, advances and loans made and to be made by the Bishop Trust Co. and interest thereon, although it now appears to have become certain that, mainly in consequence of the depression, there will be no such excess to apply on account of said notes; said agreement to continue to apply in respect of such assets, liabilities, contributions, advances and loans as if there were no merger except that item “(b) \$1,000 per month to the Bishop Trust Co., Ltd., for overhead or supervision” in paragraph 6 shall not be operative;

Or (2) that such holders, on the theory that such notes have become worthless and to avoid needless expense to the Bishop Trust Co., Ltd., signify their willingness that no such earmarking or accounts be kept after the merger.

A meeting will be held on Thursday, December

(Testimony of Sherwood M. Lowrey.)

Plaintiff's Exhibit P-11—(Continued)

21, 1933, at 2:30 P.M. in the Board Room of the Bishop Trust Building, at which time and place we shall be pleased to answer any and all questions and give you any information which you may desire respecting the above matters.

Thereafter we will appreciate it if you will inform us whether or not proposal (2) is acceptable to you or, if not, whether you approve of proposal (1).

Very truly yours,

HENRY WATERHOUSE
TRUST CO., LIMITED,
M. B. HENSHAW,
Vice-President.

Mr. Wild: Is it 11? I ask that it be received as Exhibit P-11 in evidence.

Mr. Atherton: Your Honor, the Government in the [194] stipulation at the end of paragraph 2—there is an objection as to the admissibility of the statements of fact contained in that paragraph made by the defendant; and paragraph 19 of the stipulation which appears on page 13, the defendant has also noted a specific objection to the admissibility in evidence.

The Court: What paragraph?

Mr. Atherton: Paragraph 19. That is the top of page 13. The defendant has noted specifically

(Testimony of Sherwood M. Lowrey.)

its objection to the admissibility in evidence of that exhibit. Otherwise, the stipulation——

The Court: Why is that objection not contained in the stipulation? Is your objection set out in the stipulation?

Mr. Atherton: Yes, it is set out in that paragraph, your Honor.

The Court: Whereabouts?

Mr. Atherton: Right after the first sentence. It reads, "The defendant objects to the admissibility in evidence of Exhibit M on the following grounds . . . "

The Court: Oh, yes. All right. We will take that up as we come to it. If you will speedily read that—if you don't read it, I will have to read it.

Mr. Wild: Well, your Honor, I want to read it, but may I start in with paragraph 26 in the stipulation, your Honor? And by that time I take it counsel will be here for the rest. [195] Paragraph 26.

The Court: Page 16?

Mr. Wild: Page 16. "During the calendar year 1932 taxpayer paid the total sum of \$4,063.33 to the following individuals in the amounts stated opposite their names." And then it gives the amounts. "Mrs. R. C. Walker, \$1,200.00; Minor children of John Fran, deceased, \$300.00; Minor children of W. Zablan, deceased, \$240.00; Mrs. Wm. Searby, \$1,800.00; Mrs. Luddecke, \$523.33."

(Testimony of Sherwood M. Lowrey.)

And giving the total of the above payments which were to widows and minor children of former employees of plaintiff.

“In its federal income tax return for the taxable year 1932 taxpayer deducted the above amounts as ordinary and necessary expenses in computing its taxable net income. The Commissioner of Internal Revenue in his first deficiency letter allowed the deduction and in his second deficiency letter disallowed the same.”

We have stipulated on that.

Q. (By Mr. Wild): Now, Mr. Lowrey, it was part of your duty as treasurer of American Factors, was it, to pass on these questions of pension payments?

A. As one of a group to pass on them, yes, before they were finally submitted to the board of directors.

Q. And were all of the pensions that were mentioned [196] by me submitted to the board of directors? A. They were.

Q. You mean all of those that I have just mentioned, they have been submitted to the board?

A. As far as I know that was the usual custom of doing it.

Q. And who determined the amount of these pensions?

A. Well, it depended—the final amount was determined or authorized by the board of directors. But in order that there could be something for the

(Testimony of Sherwood M. Lowrey.)

board of directors to act upon it was usually the department head that conferred with me about it and we in turn would then take and discuss it with the head of the business, reach a conclusion, and when we reached a conclusion we thereafter recommended it to the board of directors for action.

Q. And were there occasions when amounts of small pensions were passed by the officers of the company without a formal approval by the board?

A. I think so in those days. The list was none-too-great and some of the amounts were small. Anything that amounted to anything was submitted to the board.

Mr. Wild: I think I have given you copies of letters and so forth.

Mr. Atherton: You didn't give them to me.

Mr. Wild: I must say, your Honor, that I have been in a [197] great dither here because the Government hasn't made any copies of anything and I have tried to furnish them all. And if the Government can't find them and I can't find them, why, we were always in a to-do about it.

Mr. Atherton: I don't think those kind of remarks are appropriate, because, as a matter of fact, it seems as though he is trying to prejudice the Court against the Government.

Mr. Wild: Not at all.

Mr. Atherton: Now, counsel showed me copies of these letters in his office but he did not furnish them to me. I haven't any in my files.

(Testimony of Sherwood M. Lowrey.)

Mr. Wild: I'd be glad to turn them over to him. I am trying to cooperate with him in any way. As I say, some of them have been lost. Well, I will hand you some original certified copies of letters.

Mr. Atherton: I haven't got them. You may have thought so, but I haven't them.

Mr. Wild: I think I am clear out of them, your Honor. I just wanted to furnish copies, your Honor.

Q. (By Mr. Wild): I am showing you there an original or a copy, certified copy of a letter concerning payment to Mrs. Joseph K. Zablan. Do you have any recollection about that? (Showing a document to the witness.)

A. I know it goes 'way back. Zablan, her husband, [198] was in the employ of the company for many, many years. And from a notation that I had the chief accountant who keeps the records make on these letters, it said that Zablan worked for the company from 1899 to 1926, a period of 27 years. And then I do know that Mrs. Zablan, from information I gathered this morning, worked intermittently. Then she came on the payroll in 1928 and worked until 1933, a period of five years.

Q. And when was this pension for her approved?

The Court: It wasn't for her; for her minor children.

Q. Her minor children.

(Testimony of Sherwood M. Lowrey.)

A. In 1928 it appears to be.

Q. And what was the amount of that payment, if it shows there?

A. Ten dollars per month for each child.

Q. I see.

A. Beginning with the month of September '28 and continuing until further notice.

Q. And was that pension in force during the year 1932?

A. So far as I know. If it was shown on the account as a pension and a deduction for Federal taxation purposes, it would be indicated; it would be; it would have been.

Q. Well, it has been stipulated that that amount was paid to her.

A. Yes, and that is correct.

Q. And what was that pension paid on account of?

A. The faithful services that the father had rendered the company together with a smaller amount that the mother had rendered the company; and in order to help those children get through their schooling so that they could become independent and as citizens within the community.

Q. Now, is there a reference to minor children of John Frank, deceased there? It is stipulated that three hundred dollars was paid to or for the minor children of John Frank, deceased, in the amount of three hundred dollars.

A. I asked about John Frank from some of the old-timers, and there was action taken by the

(Testimony of Sherwood M. Lowrey.)

board in regard to that in November 27, 1922. John Frank was employed as one of the packers in the grocery packing room, open stockroom where the orders would be put up and gathered together. He worked for the company for a period of 25 years; payment of a pension up to one hundred dollars per month until further action of the board be authorized.

Q. And actually that was paid, there was paid three hundred in the year 1932 as per the stipulation. Now, Mrs. R. C. Walker, twelve hundred dollars.

A. Mrs. R. C. Walker was the wife of Clement C. Walker, R. Clement Walker, who was the first treasurer. He was an employee, a certified public accountant, as I remember, who was with Mr. Bottomley in the Bank of Bishop and [200] Company. At the time Mr. Bottomley came over to assume the head, presidency of American Factors, he brought over R. C. Walker as his treasurer. And he had the greatest of confidence in Mr. Walker on account of his capabilities and his qualifications, and Mr. Walker was treasurer of the company from the time it was organized in August there of 1918 until his death the early part of 1920. He had rendered very valuable service during that formation period getting the accounts of the two

(Testimony of Sherwood M. Lowrey.)

companies together, getting a system of accounting set up in order that it could be followed through and carried along.

Q. And was this payment made to his widow, Mrs. R. C. Walker?

A. Yes, when he died there were two little girls, and the board of directors authorized the payment of one hundred dollars a month to her which had been continued from year to year, and I think is still being paid to her.

Mr. Atherton: Your Honor, I must object to the witness testifying to what the board authorized. The best evidence of that is the action taken by the board of directors in the minutes. So I therefore move that his statement as to what the board did be stricken.

Q. (By Mr. Wild): Do you have a copy of the minutes?

A. I have. Do you wish it read? [201]

Q. Well, I'd like to—

Mr. Wild: Here again is this offer, this situation. I thought I furnished counsel with full copies of everything, and apparently I didn't. This is a certified copy from the record. I showed you a certified copy, I think, of the directors' resolution. You read that in my office.

Mr. Atherton: I saw something in your office. I remember the letters but I don't remember seeing the resolutions.

Mr. Wild: Well, do you have them there?

(Testimony of Sherwood M. Lowrey.)

Mr. Atherton: No, I don't have anything.

The Witness: Yes, I have a certified copy of the resolution.

The Court: I assume they will be offered in evidence.

Mr. Atherton: Yes. I would like to look at them.

Mr. Wild: May I just check through my records here again? I had honestly thought that——

The Court: Do that while counsel is examining the document. Those purport to be certified copies of the resolutions passed by the board of directors?

The Witness: Certified to by the secretary of the company.

The Court: They relate to these so-called pensions?

The Witness: This one we are now reading pertains to Mrs. Walker. [202]

The Court: The document shows that the resolution was adopted by the board of directors?

The Witness: The motion was seconded by Mr. Dowsett.

Mr. Wild: Well, I can't find any here.

The Witness: I have an extra set that you gave me.

Mr. Wild: I had six sets made besides the original.

The Witness: I'd like to have this one on account of the notations to refresh my memory.

Mr. Wild: Well, I'd like to offer the set of the

(Testimony of Sherwood M. Lowrey.)

letters and certified copies of the resolutions in evidence, your Honor.

Mr. Atherton: Now, your Honor, I doubt that there is any proper foundation for proffering this letter in evidence.

The Court: What is the letter that you speak of?

Mr. Atherton: The letter is addressed to Mr. Swift, the merchandising manager, and it purports to be signed by the assistant manager of the merchandise department.

Mr. Wild: Very well. I will go right ahead and put on more proof on it.

The Court: The letter inquiring as to the propriety of pensions to someone?

Mr. Atherton: No, it is a letter dated September 17, 1928, and says in substance that it attaches two letters addressed to the firm dated August 28 by Mr. Lemke, administrator of the estate of Joseph K. Zablan, deceased, and [203] a copy of a letter dated August 29th to the Social Service Bureau, and that bureau's reply thereto of September 13th. Then it goes on to tell Mr. Swift that this decedent had been an employee of the coffee department and that the writer of the letter had discussed the letter with Mr. Lemke, the administrator, and that he recommended for consideration of payment ten dollars a month for each child beginning in the month of September, 1928, continuing until further notice.

(Testimony of Sherwood M. Lowrey.)

The Court: Well, that was eventually carried out by the board of directors, was it?

Mr. Atherton: It was paid. The amount was paid, yes. I will withdraw my objection to the letter, any objection to the letter, and let it go in.

Mr. Wild: I think those, all those were done.

Mr. Atherton: I will withdraw any technical objection to the admissibility of this correspondence.

The Court: Received in evidence as Exhibit P-11.

Mr. Wild: No, 12. Can't all of them go in as P-12?

Mr. Atherton: Yes.

The Witness: Do you want this to go in?

Mr. Wild: No, I want the original to go in.

(The documents referred to were received in evidence as Plaintiff's Exhibit P-12.)

Mr. Wild: I honestly thought I had more copies.

Mr. Atherton: I know you did. Do you want to ask him [204] any more questions?

Mr. Wild: I was going to ask him seriatim about them.

Q. (By Mr. Wild): Now, the pensions to Mrs. William Searby of \$1,800. Who was Mrs. William Searby?

A. She was the wife of William Searby, who was a technical mill man. He worked for many years for the Baldwin interest in Maui at H. C. and

(Testimony of Sherwood M. Lowrey.)

S. and when American Factors was formed he was taken in to head up the mill engineering department of American Factors.

Q. And about when did he die?

A. I think he was with the company for about ten years.

Q. And were his services valuable or otherwise to the company?

A. His services were valuable for the reason that during the war years Hackfeld and Company had, so to speak, stripped their plantations a great deal in order to get as much money out of them as they possibly could so that dividends could be paid to the German shareholders so the German shareholders in turn could send money home. And the physical condition and the agricultural condition of the plantations were bad. Searby had a big job in trying to reestablish and building those plantations up.

Q. And what about Mrs. Lueddecke?

A. Mrs. Lueddecke was the wife of an elderly person [205] who was a watchman on the property. And he worked with the company for something, I think, a little over 25 years, 24 years, 1899 to 1923. In other words, with these old-timers who were kept on the payroll after American Factors took it over from Hackfeld, we recognized the services they had rendered to the predecessor, our predecessor, because, on account of there being a change in there it was no fault of those employees,

(Testimony of Sherwood M. Lowrey.)

and therefore, for the purposes of a pension or assistance in their old age to their families, we recognized the services that they had rendered. And on the basis that it was, so to speak, undisclosed liability, a moral liability, at least, when Factors having taken over Hackfeld and Company as a going concern, to do that which we considered was right towards those employees, their widows and children.

Q. And was it or wasn't it made on account of the value of past services rendered?

A. On account of the past services. That was all taken into consideration, what the man had done, how valuable his services had been to the company, and over what period of years.

Mr. Wild: No further questions on that issue.

Cross-Examination

By Mr. Atherton:

Q. Mr. Lowrey, this Mr. Joseph K. Zablan, deceased, what compensation did the company pay him while he was alive and in the employ of the company? [206]

A. I cannot tell you. The records of the company would show, but it is a point that I never had anything to do with, making up the payrolls, and a lot of the minor employees I'd have little to do with the rate of compensation that was paid.

Q. Did you have anything to do with fixing the amount of the so-called pensions? A. I did.

(Testimony of Sherwood M. Lowrey.)

Q. What was the basis upon which you arrived at a payment of ten dollars a month for the support of each child of that deceased employee?

A. First of all we tried to find out what was left of the family. Having done that, we considered the length of service that the former employee had rendered the company, the length of service, how valuable that service was. And we would take into consideration the general picture of the family's condition and then try to do something which was well within reason to assist them over those critical periods when the youngster is trying to gain his education before he takes his position in life.

Q. Did the amount of the compensation, pension fixed by the company, bear any relationship to the compensation that the employee had received from the company prior to his death?

A. It did. In other words, a party who was receiving [207] a much higher salary, a higher standard plane upon which he was living, that would all be taken into consideration.

Q. Now, then, I think you testified that Mr. Walker, one of the officers of the company, was treasurer of the company.

A. He was my predecessor.

Q. Do you happen to recollect what his salary was as treasurer of the company?

A. I think it was ten thousand dollars a year.

Q. According to the minutes of the board of

(Testimony of Sherwood M. Lowrey.)

directors held on May 18, 1920, approving a monthly allowance to his family, that allowance was fixed at one hundred dollars. Was that supposed to represent additional compensation to Mr. Walker in any sense?

A. Different compensation paid to the family on account of the valuable service that he had rendered. It was not any great amount for the simple reason he hadn't been with the company any longer period of years. I think it was about 18, 20 months he was with us.

Mr. Wild: It's surprising to me that the Government would jump on the company for treating its employees that way.

Q. (By Mr. Atherton): Did the company have any pension plan?

A. A formal pension plan? [208]

Q. Yes.

A. No, we did not. Everything was considered along these lines on an informal basis.

Q. Well, the amounts of these so-called pensions were fixed for any stated periods of time or were they to continue at the pleasure of the board of directors?

A. I think you will notice some of those until further action by the board. In other words, they were more or less continuous but if circumstances came up whereby the management wished to make a recommendation for a change, it might be up on account of illness coming in or it might be down on account of a child having finished his schooling,

(Testimony of Sherwood M. Lowrey.)

or something like that; until further action of the board, then they kept on going. And it wasn't until latter years that the entire list was reviewed each year.

Mr. Atherton: I don't think I care to examine the witness any further on this particular issue.

The Court: Was it that you felt these employees had been underpaid during their lifetime and they should be paid something to their dependents after they were dead?

The Witness: I do not think that was the case. There was more or less in any community a going scale of wages which you have to meet if you are continuing in business. We met that. But in all cases, at least in a large number of cases, when disaster comes to a family, when the bread-winner has been knocked out, and in recognition of the faithful services rendered by these individuals the company felt obligated to take and assist those families until a readjustment could be made.

The Court: Well, was it regarded merely as a gift?

The Witness: No, sir, it was not, because it was in recognition of the services and what the services were and what the man had been paid, the number of years that he had been in service with the company, were all taken into consideration.

The Court: All right. That's all.

Mr. Wild: Might I ask one question there?

Q. (By Mr. Wild): Mr. Lowrey, you were

(Testimony of Sherwood M. Lowrey.)

treasurer of American Factors, Limited for the years '32, '33 and so on, and the years before?

A. Yes.

Q. And pensions to these very same people were always allowed by the Internal Revenue Department for those other years?

A. As far as I know.

Mr. Atherton: Your Honor, I move to strike that as being immaterial and irrelevant to the issue here.

Mr. Wild: They ruled on it again and again. And under that regulation which I cited to your Honor, the mere payment is sufficient to allow deductions.

The Court: I don't feel inclined to grant the motion [210] to strike.

Mr. Wild: Very well. Now, may it please the Court, we turn to the issue of the deduction of the Henry Waterhouse Trust Company note loss. Would it be to your Honor's pleasure that I read the stipulation first and then have Mr. Lowrey testify?

The Court: Does all the remainder of this stipulation run to that item?

Mr. Wild: Yes, your Honor, except the first paragraph, your Honor.

The Court: Yes, the first paragraph may be skipped.

Mr. Wild: May what?

The Court: You may omit the first paragraph.

Mr. Wild: Yes. "II. American Factors, Lim-

(Testimony of Sherwood M. Lowrey.)

ited, at the end of the calendar year 1930 had a capital of \$10,000,000.00, and its books showed a surplus and undivided profits of \$5,971,049.93 or a total capital and book surplus of \$15,971,049.93. At the end of the calendar year 1930, and during the entire calendar year 1931, American Factors, Limited, was agent for thirteen sugar plantations and other corporations located in and carrying on business in the Hawaiian Islands, which corporations, according to their books and annual reports, had a total capital of \$26,944,720.00 and a total surplus and undivided profits of \$21,411,420.24, or a total capital and surplus as of December 31, 1930, of \$48,356,140.24. On [211] December 30, 1930, American Factors, Limited, and the companies for which it served as agent had on deposit in the banks of the Territory of Hawaii at least a total sum of \$1,741,696.24. The Defendant objects to admissibility in evidence of the aforesaid facts on the ground of their immateriality and irrelevance."

The Court: Well, the purpose of that is to build up in what substance you can of the reason and purpose for making this contribution to save Henry Waterhouse Trust Company?

Mr. Wild: In part, your Honor. That's right. Only I don't call it a contribution. I say it is a loan.

The Court: For what other purpose than that?

Mr. Wild: Merely to bring this case within certain authorities dealing with the position of the company, you see, your Honor, but that is the

(Testimony of Sherwood M. Lowrey.)

ultimate, really the ultimate purpose. I really think that we could say the main purpose is to show the business reasons why American Factors, Limited would be willing to make a trifling loan for the purpose among others of safeguarding the financial interests of itself and its agents, especially where by making such a loan there was a reasonable and justifiable expectation of having it repaid.

The Court: Well, that is a matter of argument. I can see no prejudice to the Government in letting that come in evidence. Do you wish to reserve an exception? [212]

Mr. Atherton: No, your Honor. I won't reserve an exception to that.

The Court: Proceed, then.

Mr. Wild: "III. The Henry Waterhouse Trust Company, Limited (hereinafter called the Waterhouse Company), was incorporated under the laws of the Territory of Hawaii on November 26, 1902, to engage in the business usual and permitted to a trust company under the laws of the territory. In addition to engaging in the usual fiduciary business common to all trust companies, it operated a plantation agency department, a real estate department, a stock and bond brokerage department, and an insurance department, and at times invested in stocks and bonds to a limited extent on its own account, these various activities being permissible under the Hawaiian statutes."

The Court: No objection?

Mr. Atherton: No objection.

(Testimony of Sherwood M. Lowrey.)

Mr. Wild: "IV. In the middle of October, 1930, Waterhouse increased its capital stock from \$200,000 to \$400,000, consisting of 4,000 shares of a par value of \$100 each. The new shares were all taken by the old stockholders who paid for them in cash at par. In November the effects of the general business depression began to be felt in the Territory of Hawaii, and as a large part of the Waterhouse assets consisted of real estate and mortgages, its secretary became [213] apprehensive that if many calls were made on its demand accounts the Company's financial condition would not be sufficiently liquid to meet its cash requirements. He discussed the situation with the treasurer and auditor of Waterhouse and then advised the management of Bishop Trust Company, Limited, hereinafter called Bishop Trust, that a sale of the stock might be arranged, suggesting a price of \$100 each or more for the shares."

Mr. Atherton: No objection.

Mr. Wild: "V. An Audit Report dated March 31, 1931, signed H. C. Tennent and Co. by E. J. Greaney disclosed the book value of assets of the Waterhouse Company as of February 14, 1931, to be in the amount of \$4,820,090.92 and the liabilities, exclusive of capital and surplus, to be in the amount of \$4,149,437.06. This Audit Report contained the following statement:

" 'The Contingent Reserve (for losses) of \$680,803.15 and the Special Contingent Reserve of \$400,000.00 referred to above, are considered adequate

(Testimony of Sherwood M. Lowrey.)

to cover probable losses in the realization of the assets and liquidation of liabilities.'

"It is also stated in the Report that the principal purpose of the Audit was to establish as accurately as possible the total assets and liabilities as of February 14, 1931, the date control of the Company passed to the Bishop Trust Company, [214] Limited, through its acquiring all of the stock of the Waterhouse Company."

Mr. Atherton: No objection.

Mr. Wild: "It is also stated in the Report that Exhibit A attached thereto, a copy of which is hereunto annexed and made a part hereof as Exhibit A, shows the Capital and Surplus of the Waterhouse Company as of February 14, 1931, before adjustment, the total estimated losses finally agreed upon as acceptable to the Bishop Trust Company, Limited, and the manner of arriving at the Contingent Reserve (for losses) and the Special Contingent Reserve. In this connection, the Report states, by way of explanation of said Exhibit A, that the balance sheet shows the Profit and Loss account with a debit balance of \$400,000.00 offset against the Contingent Reserve (for losses); and that this appears as preferable for balance sheet purposes to the alternative of clearing the Capital Stock Account, and produces the same net result."

Mr. Atherton: No objection.

Mr. Wild: "By way of explanation of Exhibit D attached to the Report, it is stated that the Special Contingent Reserve, as shown in Exhibit A

(Testimony of Sherwood M. Lowrey.)

above, will remain intact until actual losses written off have fully exhausted the Contingent Reserve (for losses) of \$779,717.23; and that additional losses as determined will then be applied pro rata against the Special Contingent Reserve contributions." [215]

Mr. Atherton: No objection.

Mr. Wild: "VI. Mr. A. W. T. Bottomley, president of American Factors, Limited, and of the Bishop First National Bank of Honolulu and vice-president of the Bishop Trust Company, Limited, called a conference of the heads of the four Hawaiian sugar agencies, the president of the Bank of Hawaii, Limited, the president of the Hawaiian Trust Company, Limited, and two members of the finance committee of the Bishop Trust Company, Limited, to present to them the financial condition of the Waterhouse Company and discuss the feasibility of making some plan to prevent the Waterhouse Company from being forced into liquidation."

Mr. Atherton: No objection.

The Court: What Hawaiian sugar agency is referred to? Is that disclosed there?

Mr. Wild: It doesn't show. Alexander and Baldwin, Castle and Cooke, American Factors were three of them. They all came in and advanced money. The Government stated to me that that was accurate, and to my knowledge there had been only three of them, but I am willing to state that four—

(Testimony of Sherwood M. Lowrey.)

The Court: Brewer and Company, and Davies and Company?

Mr. Wild: No, they didn't come in. I have no information, your Honor. My information is that there were only three, and counsel for the government said it was only four. And I said I don't care. I will stipulate on his statement. [216]

"VII. The Waterhouse Company was conducting business as usual but was encountering some financial difficulties; economic conditions were not clear, and, after the investigation, the executives of the Bishop Trust Company, Limited, wished to look further into the matter before acting. After February 1, 1931, the Bishop Trust Company, Limited, advised the Waterhouse Company shareholders that it would not pay cash for their shares as had previously been suggested. On Saturday, February 14, 1931, Mr. W. F. Frear, president of the Bishop Trust Company, Limited, at a meeting of the board of directors of that company made a statement which was recorded on the minutes as follows:

'This is a special meeting called to consider a proposition to take over the Henry Waterhouse Trust Co., Ltd. At first it was a proposition to purchase the stock of that company, somewhat as we purchased the stock of the Pacific Trust Co., but as a result of investigation, it changed largely to a salvage proposition.

'The plan now is for our Company to acquire all the stock of the Waterhouse Trust Co. without cost; for Mr. and Mrs. R. W. Shingle and Mr. A. N.

(Testimony of Sherwood M. Lowrey.)

Campbell in settlement of their indebtedness to the Company, to pay into it \$535,000.00 and to convey to its order their respective 18% and 10% undivided interests in [217] certain land, fish ponds and fishery at Kalihi, the same to be sold for \$87,000.00 and the proceeds, with \$13,000.00 additional contributed by the Bishop Trust Co., to make up an even \$100,000.00, to be paid into the Waterhouse Trust Co., making in all \$635,000.00 thus paid in. In addition, a number of corporations and individuals are to contribute various sums aggregating \$400,000.00, thus making altogether \$1,035,000.00 of cash to be paid into the Waterhouse Trust Co. The Bishop Trust Co. is to pay such amount, if any, as may be required in addition to enable the Waterhouse Trust Company to meet its liabilities, but it is hoped that no such contribution will be required. That, however, remains to be seen.

‘The Bishop Trust Co. is to take over, without other cost, the business of the Waterhouse Trust Co., other than the assets and liabilities, and to operate such business at its own expense and for its own benefit. This will include the trusts, executorships, agencies, insurance, safe deposit business, etc., with the necessary furniture, equipment and supplies therefor. It is hoped also that the Bishop Trust Co., will profit through making new contacts. The stock and bond and real estate departments will probably be discontinued.

‘The assets and liabilities of the Waterhouse Trust [218] Co. are to be gradually liquidated by

(Testimony of Sherwood M. Lowrey.)

applying the assets to the liabilities, together with the expenses of liquidation, including \$1,000.00 a month to be paid to the Bishop Trust Co. for supervision.

‘In final settlement, if there is an excess of assets over liabilities, it is to be applied, first, to the reimbursement of the amount, if any, that may be contributed by the Bishop Trust Co. in addition to the \$1,035,000.00, and, secondly, pro rata to the contributors of the \$400,000.00 with simple interest at 4%, and, thirdly, the balance, if any, to go to the Bishop Trust Co.

‘There are three objects: First, to prevent the failure of such a company as the Waterhouse Trust Co., with the consequent general disastrous effects; secondly, to prevent loss on the part of many who have entrusted their money to the Company for investment and who can ill afford the loss; and, thirdly, to enable the Bishop Trust Co. to acquire new business. These three objects naturally appeal with different degrees of force to different groups of contributors.’

The plan, as outlined, was approved by the Board of Directors of the Bishop Trust Company, Limited, at that meeting. The transactions mentioned in the second paragraph of Mr. Frear’s statement, *supra*, were duly performed within a [219] few days after February 14, 1931.”

Mr. Atherton: No objection.

Mr. Wild: “VIII. Prior to the consummation of the transactions hereinbefore mentioned, the fol-

(Testimony of Sherwood M. Lowrey.)

lowing individuals and corporations promised to pay to the Waterhouse Company, upon consummation of the proposed plan, the sums of money set opposite their names, to wit:

Name of Contributor	Amount Paid
The Bishop Company, Limited	\$100,000
American Factors, Limited	50,000
Alexander & Baldwin, Limited	50,000
Castle & Cooke, Limited	50,000
W. R. Castle	50,000
Beatrice Castle Newcomb	50,000
Bank of Hawaii	25,000
Hawaiian Trust Company, Limited	25,000
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Total	\$400,000''

Mr. Atherton: No objection.

Mr. Wild: "IX. Annexed hereto as Exhibit B and made a part hereof is an excerpt from the minutes of the meeting of the Board of Directors of American Factors, Limited, held on March 2, 1931, authorizing the aforesaid payment of \$50,000 to the Waterhouse Company. There are also annexed hereto and made a part hereof as Exhibits C, D, E, F and G, excerpts from the minutes of the Directors' meetings of the corporations who made their respective payments to the aforesaid \$400,000 fund of the Waterhouse Company."

Mr. Atherton: No objection.

Mr. Wild: "X. The plan of reorganization of

(Testimony of Sherwood M. Lowrey.)

the [220] Waterhouse Company was carried out as outlined above, and the individuals and corporations whose names appear in the preceding paragraph of this stipulation actually paid into the Waterhouse Company the amounts of money stated opposite their respective names upon the provisions concerning the repayment thereof as more particularly stated in the letters to Plaintiff dated February 21, 1931, and February 24, 1931, copies of which are attached hereto and made a part hereof as Exhibits H and I, respectively. Letters identical in form as Exhibits H and I were addressed to each of the individuals and corporations that made payments to the Waterhouse Company aggregating \$400,000, and said letters were duly received by each such individual and corporation.”

Mr. Atherton: No objection.

Mr. Wild: “XI. Attached hereto and made a part hereof for all purposes and marked Exhibit J is a true copy of a promissory note executed and delivered by the Waterhouse Company to Plaintiff in the principal sum of \$50,000.00, being the note referred to in said letter, Exhibit H. Notes identical in form were executed and delivered by the Waterhouse Company to each such other corporation and to each such individual, which said notes were in each instance for the principal sum of money as stated opposite the name of the respective individuals and corporations hereinbefore stated.”

Mr. Atherton: With respect to that paragraph, your Honor, [221] I would like to delete the word

(Testimony of Sherwood M. Lowrey.)

“promissory” before “note.” I don’t wish to accede on the part of the Government that that was really a promissory note.

Mr. Wild: This has already been signed up, your Honor, subject merely to objection, not as to the meat. I submit, your Honor, that we have already signed this stipulation. It was never requested—as a matter of fact, the great bulk of this the Government asked for, and it is already signed up.

Mr. Atherton: It hasn’t been filed.

Mr. Wild: I have offered it in evidence.

Mr. Atherton: It hasn’t been filed yet. True enough, a great many of the statements made here were suggested by the Government——

The Court: You wish to set out that this is a promissory note in a technical sense? The note reads, for value received Waterhouse Trust promises to pay.

Mr. Atherton: It is a conditional promise to pay.

The Court: It is conditional, no doubt about that.

Mr. Atherton: I don’t want any admission that that is a promissory note to preclude the Government from being paid.

The Court: Well, the note is referred to as Exhibit J. Call it what you want here. The note speaks for itself. I don’t think it is an admission on the part of the Government in signing this stipulation that it is in all strict technical respects a promissory note. [222]

Mr. Atherton: That’s all. I want to save an

(Testimony of Sherwood M. Lowrey.)

objection, so I'd like the record to show that.

The Court: Well, that might have been noticed before, that it is a conditional note. Go ahead.

Mr. Wild: "XII. The actual owners of the capital stock of the Waterhouse Company on February 14, 1931, shortly prior to the transfer of the stock of that company to the Bishop Trust Company, Limited, were as follows:

Stockholder	Shares	Par Value
A. N. Campbell	1,235	\$123,500.00
R. W. Shingle	1,235	123,500.00
A. L. Castle	700	70,000.00
J. K. Clarke	480	48,000.00
Harriet E. Wight	100	10,000.00
C. L. Wight	100	10,000.00
Marietta Withington	50	5,000.00
Arthur Withington	50	5,000.00
Estate of E. M. Lewis	50	5,000.00
<hr/>		<hr/>
Total	4,000	\$400,000.00"

Mr. Atherton: No objection.

Mr. Wild: "XIII. The four stockholders whose names appear first on the above list, namely, A. N. Campbell, R. W. Shingle, A. L. Castle and J. K. Clarke, were directors of the Waterhouse Company. Mr. W. R. Castle, father of A. L. Castle, purchased from the stockholders, other than Messrs. Campbell,

(Testimony of Sherwood M. Lowrey.)

Shingle and Clarke, their shares of the capital stock of the Waterhouse Company as follows:

Stockholder	Shares	Par Value
Harriet E. Wight	100	\$10,000.00
Charles L. Wight	100	10,000.00
Marietta Withington	50	5,000.00
Arthur Withington	50	5,000.00
Estate of E. M. Lewis	50	5,000.00
<hr/>		<hr/>
Total	350	\$35,000.00

Thus, on February 14, 1931, the following persons were the stockholders of the Waterhouse Company, and they were the owners of the number of shares shown opposite their names, to wit:

Stockholder	Shares	Par Value
A. N. Campbell	1,235	\$123,500.00
R. W. Shingle	1,235	123,500.00
A. L. Castle	700	70,000.00
W. R. Castle	350	35,000.00
J. K. Clarke	480	48,000.00
<hr/>		<hr/>
Total	4,000	\$400,000.00''

Mr. Atherton: No objection.

Mr. Wild: "XIV. The \$400,000 par value of capital stock of the Waterhouse Company was transferred by the aforesaid stockholders to the Bishop Trust Company, Limited, as of February 14, 1931, and the cash balances, properties, stocks and bonds,

(Testimony of Sherwood M. Lowrey.)

accounts, books and records of the Waterhouse Company came under the management and control of the new stockholder, the Bishop Trust Company, Limited. New officers and directors were elected, a finance committee, comprised of officers and directors, and an advisory committee comprised of representatives of the \$400,000 noteholders, were appointed, and work was immediately commenced on the liquidation of the [224] Waterhouse Company.”

Mr. Atherton: No objection.

Mr. Wild: “XV. There is annexed hereto as Exhibit K and made a part hereof condensed balance sheets of the Waterhouse Company as at February 14, 1931, before and after the reorganization.”

Mr. Atherton: No objection.

Mr. Wild: “XVI. On May 29, 1931, the vice-president and manager of the Bishop Trust Company, Limited, who was also a director of the Waterhouse Company, stated to the board of directors of the Bishop Trust Company, Limited, that the operation of the Waterhouse Company business was causing a monthly loss ‘as it is in the nature of a receivership.’ He added the belief that ‘the bulk of the work in straightening out the affairs of the company will be accomplished within a year or two.’ At a meeting of June 26, 1931, he advised the board of directors of the Bishop Trust Company, Limited, that:

“* * * he had made a recommendation to the Bishop Trust Company of a transfer of all of the work of the Waterhouse Trust Company directly

(Testimony of Sherwood M. Lowrey.)

to the Bishop Trust Company, with the exception of the collection agency end of the business.'

At the same time he stated his belief that the Bishop Trust Company, Limited, would suffer no loss if business should [225] again become normal. Thereupon the Bishop Trust Company, Limited, took over some of the Waterhouse Company business, but the Waterhouse Company continued to do some business until it, the Guardian Trust Company, Limited, and the Pacific Trust Company, Limited, were formally merged into the Bishop Trust Company, Limited, on December 30, 1933 as hereinafter set forth."

Mr. Atherton: No objection.

The Court: Who was that officer?

Mr. Wild: I think that was M. B. Henshaw, who is at present absent on the mainland, your Honor.

The Court: No objection?

Mr. Atherton: No objection.

Mr. Wild: Does your Honor want to take a short recess?

The Court: Yes, I will be glad to.

Mr. Wild: I think this is a convenient point.

(A short recess was taken at 3:00 p.m.)

After Recess

Mr. Wild: "XVII. There is annexed hereto as Exhibit L and made a part hereof condensed balance sheets of the Waterhouse Company as at December 31, 1931, and December 31, 1932."

Mr. Atherton: No objection.

Mr. Wild: "XVIII. The advisory committee referred to in Exhibit I was composed of prominent business and professional men who represented the aforesaid note holders who had made [226] payments into the aforesaid \$400,000.00 fund. The original committee consisted of:

1. A. W. T. Bottomley (now deceased) whose alternates were S. M. Lowrey, who was then Plaintiff's treasurer, and H. A. Walker who is now president of the Plaintiff.

2. C. H. Cooke, then president of the Bank of Hawaii, Limited, whose alternates were R. McCorriston, now a vice-president of the Bank of Hawaii, Limited, G. G. Fuller, now retired, who was a vice-president of the Bank of Hawaii until his retirement, and E. W. Carden who is now president of the Bank of Hawaii.

3. A. L. Castle, an attorney at law, at present a partner in the firm of Robertson, Castle & Anthony, whose alternates were F. C. Atherton (now deceased) then the president of Castle & Cooke, Limited, and A. G. Budge, now president of Castle & Cooke, Limited.

The composition of the advisory committee changed from time to time thereafter and among the other persons who attended meetings as a member of the committee was: James L. Cockburn who was then the executive vice-president of Bishop & Company, Limited.

This committee met frequently with the finance

committee of the Waterhouse Company and passed upon all matters of importance affecting that Company and particularly those matters tending to affect the amount of reimbursement, if any, [227] ultimately to be made to the special note holders. It advised with Bishop Trust Company, Limited, and its members were consulted from time to time by the Plaintiff and other special note holders."

Mr. Atherton: No objection.

Mr. Wild: "XIX. Under date of July 18, 1932, the Waterhouse Company, over the signature of M. B. Henshaw, vice-president, dispatched to the Plaintiff a letter, a true copy of which is annexed hereto as Exhibit M and made a part hereof. The defendant objects to the admissibility in evidence of Exhibit M on the following grounds."

Maybe you want to read them. Or shall I?

Mr. Atherton: You go ahead.

Mr. Wild: "Viz: (a) that the statements made therein are immaterial to any issue involved herein; and (b) that its admission in evidence for the purpose of proving the truth and accuracy of the statements made therein concerning the reappraisal of the assets and liabilities of the Waterhouse Co., and the competency and accuracy of such reappraisal would constitute a violation of the hearsay rule, and such evidence is also incompetent."

Now, that is the objection to that letter. Now, the rest of it is not a part of the objection. It reads:

"Letters identical in form to Exhibit M were dispatched by the Waterhouse Company to the other

note holders and [228] received by them. The advisory committee was not abrogated but continued to function as usual during the balance of the year 1932 and the year 1933."

The Court: What is that exhibit?

Mr. Wild: Exhibit M. Exhibit M is the letter of July 18, 1932. Shall I read it to your Honor off the record?

The Court: Yes.

(Exhibit M, letter dated July 18, 1932, from Henry Waterhouse Trust Co. to American Factors, Ltd. was read by Mr. Wild.)

The Court: What is the objection?

Mr. Atherton: The objection to that exhibit and all the other ones that are copies thereof addressed to the other note holders is that the statements made therein are immaterial to any issue involved in this litigation; that its admission in evidence for the purpose of proving the truth and accuracy of the statements made therein concerning the reappraisal of the assets and liabilities of the Waterhouse Company, and the competency and accuracy of such reappraisal, would constitute a violation of the hearsay rule, and such evidence is also incompetent.

The Court: Yes, but as I see it, these note holders did get such letter from the vice-president of the Waterhouse Company. It was argumentative but they threw up the sponge. Whether it had any influence on them collectively or individually, [229] I don't know. But they did receive such a letter.

Whether it is true or whether the letter is true or false in its statements——

Mr. Atherton: I am not objecting to the fact that they received such a letter and that the letter requested them to concede the worthlessness of the note, but I am objecting to the admissibility of the letter for the purpose of showing that there was any justification or any reasonable ground for determining the note to be worthless in 1932. Now, it could be admitted for a limited purpose.

The Court: The letter certainly doesn't admit the evidence that the note was worthless beyond an argumentative assertion of the vice-president of this company who wanted to get rid of the note, and urged it upon the note holders.

Mr. Atherton: Well, then, all my objection is, is that it might be admissible for the limited purpose of showing that he addressed the note holders such a letter and in that letter he asked them to concede the worthlessness of the note, but all other statements in there must not be taken as having been true.

The Court: As true. Well, that follows. They can't be taken as true; just merely that Mr. Henshaw wrote that.

Mr. Atherton: Well, I want to be sure.

The Court: I think that is understood by counsel and the Court. [230]

Mr. Wild: Why, yes, your Honor. This is part of the *Res gestae*, just like the other letter.

The Court: It couldn't be argued in the case

that because Mr. Henshaw made these statements for the purpose of urging the cancelling of the notes that all of his statements were true, or any of them are true for that matter.

Mr. Wild: Well, as I take it, the letter was evidence of what was stated there.

The Court: That's right.

Mr. Wild: And it doesn't go any beyond that.

The Court: It is not evidence of the truthfulness of the statements.

Mr. Wild: No, that's right. I will agree with that, your Honor, heartily.

The Court: Well, we may go on with the objection noted.

Mr. Wild: "XX. During 1933 for the stated purpose of simplifying its financial structure and effecting economies, Bishop Trust Company, Limited, decided to effect a merger. Attached hereto, made a part hereof for every purpose, and marked Exhibit N is a copy of a letter dated December 19, 1933, sent by the Waterhouse Company to The Bishop Company, Limited. Letters identical in form with Exhibit N were sent to and received by each of the aforesaid Waterhouse Company note holders."

Mr. Atherton: No objection. [231]

Mr. Wild: That is something he replies on the same thing as true there. Would it please your Honor if I would read the exhibits as we went along?

The Court: That is Exhibit N? That is another letter?

Mr. Wild: Yes, your Honor. I have omitted the exhibits because I thought we would read them as we went along after we had read the others, but we might as well read these.

The Court: The letter to George P. Rea, the executive officer of the Bishop Company. Is that Bishop Trust Company or Bishop what?

Mr. Wild: May I say there has been a slip here. There was a similar letter written to everybody. There is one written to American Factors. Exhibit N was supposed to be the letter addressed to American Factors, you see, but through error they copied the wrong one. It makes no difference because the same type of letter was sent to American Factors, and it says——

The Court: Is that conceded?

Mr. Atherton: That is conceded.

The Court: Now, I don't think it is necessary for you to take the time to read this unless there is some very different material in it. It is written by Henshaw, and he was making a further argument, was he, to just cancel the note?

Mr. Wild: Yes. The purpose of this is that the Government [232] wants to show by it, your Honor, that on December 29, '33, which is long after the year '32, that Henshaw asked the note holders to agree to surrender their notes then and call them worthless and release the committee. And then there is in the stipulation the statement of what was done

after that. Now, technically none of that stuff should go in the record because it is after the particular year. But I haven't any objection in entrusting it to your Honor. You see, there were two alternatives in the letter. They propose—the Bishop Trust was about to merge the Henry Waterhouse Trust and the others, and they wanted to terminate this committee and have the note owners concede that it was worthless and not have to set it up.

The Court: Well, he started out on that. They did.

Mr. Wild: In '32.

The Court: In July '32?

Mr. Wild: That's right.

The Court: And apparently it wasn't responded to.

Mr. Wild: That's right. They all didn't turn in. Now, the next paragraph is 21.

“On December 21, 1933, a meeting of the said Waterhouse Company noteholders was held at which the holders of \$300,000 out of a total of \$400,000 of the notes outstanding were represented as follows:

Noteholder	Amount of Note Held
American Factors, Ltd., S. M. Lowrey, representative	\$ 50,000
Alexander & Baldwin, Ltd., C. R. Linden, representative	50,000
The Bishop Company, Ltd., George P. Rea, representative	100,000

W. R. Castle, Alfred L. Castle representative	50,000
Alfred L. Castle, as executor under will of Beatrice Castle Newcomb, deceased, Alfred L. Castle, representative	50,000
	<hr/>
Total	\$300,000

The noteholders who were not represented at this meeting were:

Noteholder	Amount of Note
Castle & Cooke, Ltd.	\$ 50,000
Bank of Hawaii	25,000
Hawaiian Trust Co., Ltd.	25,000
	<hr/>
Total	\$100,000

Present by invitation were Messrs C. F. Weeber and M. B. Henshaw. The minutes of the meeting record that—

‘Mr. Henshaw stated that the purpose of the meeting was to consider the letters dated December 19 which had been sent out to all of the corporations and/or individuals who had loaned money to Henry Waterhouse Trust Co., Ltd., in February, 1931.’

And after some discussion it was the unanimous opinion of those present that proposal No. 1 as set forth in the letters dated December 19, 1933 (Exhibit N), be approved.

The minutes of that meeting also record that—

‘Mr. Linden suggested that after the proposed

merger the Advisory Committee be continued, at least until such time as the question of whether the notes held by [234] the underwriters become a loss in the year 1932, is definitely settled. It was the consensus of opinion that this suggestion be followed.' "

Mr. Atherton: No objection, your Honor.

Mr. Wild: May it please the Court, we take the position in regard to that paragraph that it is wholly immaterial what was done after. The Government wants it in. All right.

Mr. Atherton: With respect to paragraph 20, I don't know whether the record shows that the Government interposed no objection to that.

Mr. Wild: I think it shows. But if it doesn't, I am not interposing—

The Court: I have a note, "No objection."

Mr. Atherton: I just wanted to be sure. I didn't recall after the discussion.

Mr. Wild: "XXII. Following the merger aforesaid, on December 30, 1933, the Bishop Trust Company, Limited, for the purpose of accounting to the aforesaid noteholders kept separate accounting records referred to as the 'Waterhouse Section,' of the Waterhouse Company assets acquired and the liabilities assumed in respect thereto. Among the records so kept, a special account designated 'Notes Payable—Underwriters H W T—New' was set up to cover the \$400,000 paid in by the aforesaid noteholders and the charges against it. This account at

December 30, 1933, showed a credit balance of [235] \$400,000."

Mr. Atherton: No objection.

Mr. Wild: "XXIII. The following is a statement of book value of the Waterhouse Company assets, exclusive of cash, on the indicated dates, actual losses sustained on liquidation to the indicated dates, set up on the latter's books, and the estimated losses on liquidation arrived at by a group of officers of the Bishop Trust Company, Limited: Book value of assets exclusive of cash, actual losses sustained on liquidation, estimated loss on liquidation. February 14, 1931, the book value of assets, exclusive of cash, is \$4,275,543.05, and no losses sustained on liquidation. December 31, 1931, \$3,697,-746.38 of assets other than cash. Actual losses sustained on liquidation that year, \$324,913.77. In 1932, book value of assets exclusive of cash, \$2,993,234.31. Actual losses sustained on liquidation, \$410,345.80."

The Court: Those were accumulative losses?

Mr. Wild: Accumulative. That is, in other words, at December 31, '32, the actual losses sustained on realization of assets was a total of \$410,-345.80, not to be added together, as we stated above. And then, at the end of '33 there were \$2,965,675.99 worth of assets, and the actual losses sustained on liquidation at the end of 1933, accumulative, is only \$571,482.80. And estimated losses on liquidation had then been reduced to \$936,352.98.

Mr. Atherton: No objection.

Mr. Wild: They estimate much less loss on

actual liquidation at the end of '33 than they did in '31. No question about that.

The Court: Well, at the end of '33, with the total reserve, including the money raised from these funds, the issue of notes, they had a fund available to meet the liquidation and losses of \$1,080,803?

Mr. Wild: Yes, Your Honor, that's right. In other words, the book shows——

The Court: At the end of '33 they exhausted it or——

Mr. Wild: That's right.

The Court: ——still some value?

Mr. Wild: Above those of the notes.

The Court: Yes, something that appeared to be available in application against the payment of the notes?

Mr. Wild: Well, at that time they didn't need—at the end of '33, Your Honor, on actual liquidations they hadn't used up any of the money on those notes. They hadn't even gotten to it, because they had a \$700,000 capital and surplus item that had to come out first. There were still some three hundred thousand dollars.

The Court: Available?

Mr. Wild: Available before they had to touch the note [237] surplus. That's what this account shows, Your Honor, without any question.

The Court: At the end of '33?

Mr. Wild: At the end of '33. That is, on the actual liquidation of assets with the reserve set-up, with the surplus that had to be eaten up for three-

quarters of a million first. They had only eaten up of that three-quarters of a million \$400,000. They still had four hundred thousand to go before they hit the notes.

“XXIV. Plaintiff’s books of account were kept on the accrual basis of accounting, and, during the calendar years 1924-1932, inclusive, they were so kept, and its Federal Income Tax returns for those years made on that basis of accounting. In the calendar year 1932, Plaintiff charged off on its books of account the face amount of the aforesaid \$50,000.00 Waterhouse Trust Company promissory note which was given to the Plaintiff in the year 1931, pursuant to the actual method of charging off bad debts which the plaintiff used in that taxable year and all prior taxable years for income tax purposes.”

Mr. Atherton: Now, Your Honor, first there is apparently a typographical error here, the omission of the word “were” before the word “made” on the fourth line down in that paragraph. “Were made” it should be, I think.

Mr. Wild: That is right. There is a typo there.

The Court: Federal tax returns for those years “were made?”

Mr. Wild: I think I read it “were made.” But the word is omitted. May that be corrected?

Mr. Atherton: The Government would also like to delete from that paragraph the word “promissory” before the word “note” which appears on the seventh line down.

The Court: “. . . the aforesaid \$50,000.00 Water-

house Trust Company promissory note . . .” Well, may there be an understanding that that note wasn’t strictly a promissory note but had condition attached to it?

Mr. Wild: Well, your Honor, there is no doubt that it had conditions attached to it, but it was a promissory note nevertheless.

The Court: Promise to pay.

Mr. Wild: And as counsel has already stipulated, much of this stuff is his own language. As a matter of fact, I didn’t have any of this in. Well, I will put it in. Now he is objecting. I say it has already been signed and it is too late to object to it.

Mr. Atherton: No, it is not too late.

Mr. Wild: The Court had the note before it and it can characterize it for itself.

Mr. Atherton: It is not too late to have it deleted. It hasn’t been filed yet. [239]

Mr. Wild: Well, I have offered it all in evidence, and it has all been signed by counsel.

Mr. Atherton: But if your Honor will look at Exhibit H, in that letter of February 21, 1931, addressed to American Factors, it doesn’t characterize the note as a promissory note. And in the Government’s interest, I must protect my client’s interest, and that same objection obtains with respect to the preceding paragraph number.

The Court: Whenever it appears?

Mr. Atherton: Whenever it appears.

Mr. Wild: Now I don’t know. I may want to strike this all out. I had in my request one stipula-

tion, one paragraph on the Henry Waterhouse Trust. Government counsel wrote up all this long linguist stuff; he took it from the two prior cases which I tried in part and put it in, and that is his own language. Now, we signed it up in good faith, and I told him I'd make no objection. Now he comes along and wants to change the language. I think a good bit of it is wholly immaterial myself. But your Honor is going to refer to the note itself, and no matter how we characterize it, your Honor is going to hold it.

The Court: The note speaks for itself; that is, the note that is referred to there as Exhibit N, is it?

Mr. Wild: Yes, your Honor.

The Court: I see no prejudice in it. [240]

Mr. Wild: The note isn't handy.

The Court: There is a copy of the note in here some place. I just referred to it awhile ago.

Mr. Wild: It isn't in but it is there. Is it J? It is J. No.

Mr. Atherton: J, is it not?

Mr. Wild: J, yes, your Honor, Exhibit J. Now, are we ready to proceed, your Honor?

The Court: Yes.

Mr. Wild: "XXV. In its Federal Income Tax return for the taxable year 1932, at item 20 on page 1 thereof, the taxpayer took as a bad debt deduction the entire amount of \$50,000 paid by it to the Waterhouse Company in 1931. The Commissioner of Internal Revenue determined that the \$50,000 paid to

Henry Waterhouse Trust Company was not deductible as a bad debt deduction for the year 1932."

Mr. Atherton: No objection.

Mr. Wild: Now, we have read 26, your Honor, and that is the last paragraph. May I put Mr. Lowrey on the stand?

The Court: Yes.

SHERWOOD M. LOWREY

recalled and testified further as follows:

Direct Examination

By Mr. Wild:

Q. Mr. Lowrey, you have already been sworn in this [241] matter, and just to briefly summarize, during the calendar year 1931 and '32 you were the treasurer of American Factors, Limited, plaintiff in this cause? A. I was.

Q. As such treasurer what, if anything, did you have to do with a certain promissory note dated February 21, 1931, in the amount of \$50,000, a true copy of which is Exhibit J annexed to stipulation or Exhibit P-11? What did you have to do with that?

A. Well, first of all the note was—Mr. Bottomley, the manager of the concern, the company, after consultation with several others, worked up a plan whereby financial aid was to be given the Waterhouse Trust Company. As has been set forth in the stipulation just read, the Waterhouse Company was short of cash. At least, that is the gist

(Testimony of Sherwood M. Lowrey.)

of it. It had lots of assets but they were short of cash. They brought more cash in with the issuance of capital stock. Further cash was necessary to put them in a more liquid condition. And a group already named agreed to loan them a certain amount of money.

Mr. Atherton: Your Honor, excuse me, please, but I think the witness' answer is beyond the scope of the question.

Mr. Wild: I am just asking him what he knew about this note, what he knew about the transaction.

The Court: Well, I guess he is up to the point now of [242] telling.

A. (Continuing): Mr. Bottomley agreed with certain of the directors of his own company that it would be proper for American Factors to loan Waterhouse Trust Company \$50,000, taking therefor a note in such form as has been submitted to this Court. The loan was made to Waterhouse Trust Company. He presented the matter to me. I authorized the issuance of the check. The loan was made. The note was received. And later on the action was confirmed by the board of directors of American Factors, Limited. That was in the early part of 1931.

Q. Now, at that time, did Mr. Bottomley make any statement to you as treasurer of American Factors, Limited, during your presence concerning the possibility of collecting anything on that note?

(Testimony of Sherwood M. Lowrey.)

A. Yes, he told me that Waterhouse Trust Company—and that was the reason I made those preliminary remarks—that they were short of cash, and it was felt by the business interests in the community, so-called leading business interests, that it might be a very disastrous thing to the community as a whole should Waterhouse Trust Company fail. And, therefore, a group had gotten together to try and finance them themselves, the stockholders showing their good faith by doubling their capital and outside interests putting up the \$400,000 as has been mentioned. And it was hoped with that [243] financial assistance the Waterhouse Trust Company could, so to speak, weather the storm. We were going through our depression here, which always came later than the depression on the mainland. It has been customary here for years. We were going into the depression; we were in it. It was felt with this financial assistance the company could go ahead.

The Court: Well, I think that is beyond the scope of the question.

Q. Well, did Mr. Bottomley make any statement as to whether or not American Factors had any possibility of repayment under this note?

A. Yes, he thought that by the assistance thus granted.

Q. State what he told them.

A. He stated that it was in his opinion that by granting this assistance to Waterhouse Trust Com-

(Testimony of Sherwood M. Lowrey.)

pany they'd weather the storm and the money would be repaid.

Q. And did you review that note again during the calendar year 1931?

A. Yes. That was one of the things with which I was charged with. Each year it was a question of reviewing the accounts and notes receivable that the company owned. It was a practice to either take and write off any accounts or notes that became valueless in a certain year or else it was a question of creating a reserve in order that the balance sheet might take and show what was considered a proper asset [244] for the receivables. We considered the Waterhouse Trust Company and at the end of 1931 it was felt that the note was good and no reserve was created.

Q. Was it a part of your duty always as treasurer of American Factors, Limited, to review each year all of the receivables that were owned by the company?

A. Yes, with the assistance of the department heads. In other words, I had them prepare a list of those which in their opinion needed to be reviewed and looked into. If the accounts were perfectly all right in their opinion, they were not reviewed. Only those which were considered to be in a questionable class. If they were bad, they were written off. If there was some question or that we had not used every means of collecting them, a reserve was created. But the reserves were never

(Testimony of Sherwood M. Lowrey.)

taken into consideration in determining a taxable liability; merely for balancing purposes.

Q. And it was in connection with this regular examination of yours that you had made every year since you were treasurer?

A. Customary procedure.

Q. That you examined the Waterhouse Trust Company note in 1931? A. Yes.

Q. Now, did you as treasurer receive or see that certain letter referred to, a copy of which is annexed to the [245] complaint, I think as—not the complaint—Exhibit P-11, as Exhibit M?

A. I did.

Q. And I will show you—I have already showed counsel—the original of that letter, the original of the note, and ask you just to examine it. Did you ever see that exhibit before?

A. Comprising both documents?

Q. No, just the letter of July 18th.

A. Yes, I have.

Q. And what did you do after receiving or reading that letter?

A. Well, at that time there was this advisory committee, and, as has been shown in the stipulation, I was Mr. Bottomley's alternate or one of these alternates on that, and I attended certain meetings in his absence. I knew what the procedure the committee followed, in determining the value of the assets, and the procedure which they had adopted in gradually liquidating their assets.

(Testimony of Sherwood M. Lowrey.)

Q. Did you make any inquiry after receiving that letter?

A. After receiving this letter, knowing something about it already from my work on the advisory committee, I went into the thing more thoroughly than I had before. I took and consulted with Henshaw, and I know I discussed it with Mr. Linden of Alexander and Baldwin, although he was also at that [246] time our tax consultant, and came to the conclusion by the end of the year that the note was valueless, and in order to take and get a proper balance sheet we should wipe it off and also claim it as a tax deduction in the year in which we determined the note to be valueless.

Q. Well, now, in that determination did you make any inquiry about the assets that were remaining?

A. Oh, yes. I talked that over. I had seen the balance sheet and I talked with Henshaw and also with Bottomley.

Q. And did you make any other inquiries from any other note holders or others who had investigated it?

A. At some time—I don't know just when it was—when the question came up when these notes should be written off or whether the committee, advisory committee, should continue to function and the assets of the Waterhouse Trust Company be kept separate and distinct. Now, whether that was in 1931 or not, I have forgotten. But I do remem-

(Testimony of Sherwood M. Lowrey.)

ber that when that subject did come up I said, so far as American Factors was concerned there is no longer necessity for any advisory committee for the reason that we had already considered the note of no value and had written it off.

Mr. Atherton: Your Honor, I move to strike that, because that is contrary to the stipulation.

Mr. Wild: No, it isn't, your Honor. [247]

Mr. Atherton: Just let me say what I have to say, please.

Mr. Wild: Nothing that conflicts with the stipulation.

Mr. Atherton: In here it says, in paragraph 21 of the stipulation, it says that the proposal No. 1 mentioned in the letter of December 19, 1933, was agreed to. In other words, they didn't decide—and American Factors was one of the parties—did not decide to abrogate the committee, but that the note, that the account should be continued to be carried on the books of the Bishop Trust Company.

Mr. Wild: Well, may this witness go on and explain the whole situation?

The Court: That won't keep the witness from expressing an opinion at that meeting that so far as American Factors were concerned they would be satisfied that the committee would be done away with.

Mr. Atherton: American Factors, your Honor, was present at that meeting and were one of those who voted to continue the committee.

(Testimony of Sherwood M. Lowrey.)

The Court: Yes.

Mr. Atherton: Now, whether he expressed the opinion or not, I think is immaterial.

The Court: . Well, I think so, too.

Mr. Atherton: What action the committee took.

The Court: I think so, too, it is immaterial what discussion was there. The net result of the meeting is the only [248] thing that is material.

Mr. Wild: May he explain his vote, why he so voted?

The Witness: Simply this: I expressed my opinion. The majority wanted the advisory committee continued and the segregation of the assets maintained. And I said, all right, it doesn't do us any harm, go ahead and do it that way if you want.

Q. Now, in the year 1932, who have you to say as to whether you, as treasurer of American Factors, Limited, caused this \$50,000 to be written off the books of American Factors, Limited?

A. What did I do to cause it to be written off?

Q. Yes. Or did you? What did you do with regard to that debt?

A. When that decision had been reached by a conclusion reached by myself, after conferring with others, I remember discussing it with Bottomley and he agreed——

Q. What did you do on the books or accounts?

A. I gave instructions to the accountant to write it off, charge profit and loss with it and credit the note, and that is that for the year's operation.

(Testimony of Sherwood M. Lowrey.)

Q. And was that done on the books of the corporation that year? A. Yes.

Q. Do you have the excerpt from the books? Do you want [249] the excerpt of the books?

Mr. Atherton: Your Honor, it was stipulated that it was written off, and there is no dispute about that.

Mr. Wild: Well, no further questions.

The Court: That is merely the mechanics of it.

Mr. Wild: I think no further questions.

Cross-Examination

By Mr. Atherton:

Q. I'd like to ask you, Mr. Lowrey, when Mr. Bottomley made that statement to which you alluded in your testimony?

A. Well, I sort of quoted him several times. The statements he made to me about loaning the money in the first place were made early in the year, January, say to the middle of February, somewhere in there.

Q. What was the occasion upon which he made those statements to you?

A. As I remember it, he merely came in the office and said, "Sherwood, we have got to do this, and this is what I have obligated to the company, what I have obligated the company to after conferring with some of my outside directors."

Mr. Wild: Did you have a duty to perform at that time? What duty did you perform for the

(Testimony of Sherwood M. Lowrey.)

company at that time? That's what he is getting at.

The Witness: Is that the question you want?

Mr. Atherton: No, I was trying to get the background [250] surrounding it, or, as Mr. Wild put it, the *Res gestae* of the situation when Mr. Bottomley made these comments to you about why the company was ready to participate with others in making the contribution to the \$400,000 fund.

The Witness: I think that I explained that formerly, that they were short of cash.

Q. (By Mr. Atherton): No, I am asking what was the occasion on which he brought that up?

A. What is that?

Q. What was the occasion when he brought that up?

A. Well, I was treasurer of the company. If he promised to loan somebody some money and going to get a note for it, he would come and give me instructions so I could get a check issued by the cashier's department to give to somebody so that in turn I could get the note to complete the transaction.

Q. Wasn't that a mere formal function that didn't require any discussion between you and Mr. Bottomley as to why the company was making the loan, and wasn't it just a perfunctory performance in drawing the note and signing it?

A. If he had asked me, if he had come to me and he called me "Sherwood" and he said "Sherwood,

(Testimony of Sherwood M. Lowrey.)

I want a check payable for \$50,000, payable to Henry Waterhouse Trust Company," I wouldn't have given it to him. I'd say, what is it for, [251] what am I going to do, what voucher are you going to give me, what shall I charge the money to? I was responsible for the keeping of an account of that under the by-laws of the company.

Q. Well, at that time were you informed that the board of directors had authorized the payment?

A. They had not authorized it at that time. Some of the outside directors had approved it. And later on the whole matter was brought before the board, at which time the action of Mr. Bottomley was ratified.

Q. Then at the time that the check was drawn and the advance made there had been no formal action taken by the board of directors?

A. No formal action, no, sir.

Q. So the occasion was then rather explanatory of why Mr. Bottomley was asking you to draw the check, is that it? That was the occasion for it? Because there had been no formal action?

A. Yes, certainly. He told me the set-up and that so and so and so and so had consulted with that and they had decided it was the wisest thing to do.

Q. Now, at that time did you have any discussion with Mr. Bottomley as to what he believed to be the prospects of the company recovering repayment of that \$50,000?

(Testimony of Sherwood M. Lowrey.)

A. Yes, he told me that the shareholders had already [252] put in \$200,000; that after going over the thing very carefully, the various ones involved in these loans, they had come to the conclusion that it was to the best interests of the community, and therefore to American Factors, that Waterhouse Trust Company be assisted by the loaning of this cash, and if the money was so loaned he felt there is a perfectly reasonable chance of getting the money back.

Q. Did he give you his reasons why he thought that, why he had reached that conclusion?

A. I can't go and think back to the details as far as that. He said they were short of cash; lots of companies have been short of cash; and when their cash position has been improved it had saved them from being insolvent. It was a banking proposition.

Q. Well, now, on the books of the company that note was set up as a contingent liability?

A. No, sir, it was set up as a perfectly good asset on our books.

Q. A note was set up?

A. The note was set up as any other asset in our books. We had paid out \$50,000 and note receivable had been charged with. Therefore, it appeared as an ordinary asset in our books.

Q. Now, with respect to that Exhibit M which is attached to Exhibit P-11, the stipulation No. 1, being the letter [253] dated July 18, 1932, addressed

(Testimony of Sherwood M. Lowrey.)

to American Factors by the Henry Waterhouse Trust Company, signed by Mr. Henshaw, was any formal reply made by American Factors to the Henry Waterhouse Trust Company as requested in that letter concerning the proceeding that the note was worthless?

A. None that I have any recollection of.

Q. During the year 1932 was any discussion had by any of the officials or members of the board of directors of American Factors concerning any information they may have received about a possibility of a merger of the Henry Waterhouse Trust Company into the Bishop Trust Company?

A. Nothing so far as I know, as member of the American Factors' board. Certain members of the American Factors' board without question knew about it because some of them sat as directors on both the Bank of Hawaii and the Bishop National Bank. But nothing that I know of.

Mr. Atherton: Very well. Thank you.

Mr. Wild: Wait a minute. Did you hear that question?

The Witness: Will you repeat that question?

(The reporter read the last question.)

Q. (By Mr. Wild): But you yourself knew about the proposal to merge Henry Waterhouse Trust Company and the Bishop Trust Company by the end of the year 1933, did you not?

A. To be perfectly frank, I don't remember.

Q. Well, you met on the committee, did you not,

(Testimony of Sherwood M. Lowrey.)

to determine whether the Bishop Trust Company, Limited, was going to be required to keep an account in its books after a merger?

A. Yes, that is clear.

Q. But prior to that time you didn't know anything about the merger, is that it?

A. I don't know when that first question of the merger came up. But it did come up, for the simple reason the question came up of whether or not the accounts from the Waterhouse Trust Company we brought over to the Bishop Trust Company should be merged right with the Bishop Trust Company accounts, or whether they should be kept separate and distinct. And later on it was decided by a majority of these note holders that it would be to the best interests to keep them separate.

Q. (By Mr. Atherton): When was the first discussion about the possibility of the merger? When did that first occur?

A. I don't know, Mr. Atherton.

Q. You didn't hear, or did you hear, during the year——

A. I was not on the Bishop Trust Company board. I was not on the Waterhouse Trust Company board. And when they first began talking about it, I don't know.

Q. You don't know?

A. So far as I know, the first thing that I knew about [255] the whole thing was the early part of '31 when Bottomley came in and told me about the

(Testimony of Sherwood M. Lowrey.)

loaning of the money to the Waterhouse Trust Company. Then, after that, what took place as far as dates go I do not remember.

Mr. Atherton: Very well. Thank you.

Mr. Wild: No further questions.

(Witness excused.)

The Court: Well, we are going pretty slow. Alexander and Baldwin, will they have any witnesses?

Mr. Pratt: Yes, your Honor. We have two witnesses, I think, with respect to our case, that we expect to call.

The Court: Well, now, when can we entertain those witnesses? The first thing in the morning?

Mr. Pratt: Your Honor, I think Mr. Wild has three or four more on this issue.

The Court: Witnesses?

Mr. Wild: Yes, I have.

The Court: They will be short witnesses?

Mr. Wild: I hope so, your Honor. I don't know, of course. I expect they will be very short witnesses.

The Court: Hadn't we better start a little earlier than 10 o'clock tomorrow? I am getting quite apprehensive that this thing is going to run beyond the estimates you gentlemen gave me, three days being ample. We have been at it two good, long days now, and the plaintiff hasn't gotten near its closing. I don't know what the Government is going to have.

Mr. Wild: Do you intend calling any witnesses? I was going to review tonight the witnesses I was going to call and get in touch with them and locate them, to be sure that I can have them in court the first thing, your Honor. And if I do that too early, I won't be able to locate them maybe.

The Court: Well, you can at least reflect on the matter and hold them down to the essentials.

Mr. Wild: Very well. Is it your Honor's pleasure to start at 9:00 o'clock or 9:30?

The Court: Well, I don't want to impose on counsel's time.

Mr. Wild: Well, would 9:30 be all right? You see, your Honor, tomorrow morning or this afternoon, it is hard now to locate them some time. I have got to locate Al Castle, for instance. Al Castle represents a note holder. W. Frear I think I can get. I don't think I can get all tonight. There is a possibility of calling J. C. Clarke. These witnesses are all in connection with the Henry Waterhouse Trust note, and they will be brief witnesses. And E. J. Greaney, who made the report of the audit, I want to get him. And I told him that I'd try and put him on and let him go as soon as I could. So that those would be the witnesses I have. And I will try to locate them and get them here the first thing in the morning. [257]

The Court: Is there anything on the criminal calendar in the morning?

The Clerk: No, your Honor.

The Court: Well, suppose we say 9:30. Would that be all right?

Mr. Wild: We shall try, your Honor.

The Court: All right.

Mr. Wild: I am more anxious to conclude than your Honor.

Mr. Atherton: I'd say 9:00 o'clock.

Mr. Wild: You don't have a thing to do. You just sit there. I've got to locate my witnesses.

Mr. Pratt: Your Honor, with respect to the Alexander and Baldwin witnesses, I don't want to have them sitting here all morning. If the Court thinks perhaps we could arrange to have them here the first thing in the afternoon, it would seem to me that the four witnesses will probably take the morning.

The Court: Do you think they will, Mr. Wild?

Mr. Wild: They certainly won't from my examination.

The Court: I wouldn't think so.

Mr. Pratt: Well, then, I will have them here in the morning, your Honor.

Mr. Wild: You won't need them for an hour.

Mr. Pratt: Both of mine will be short and perhaps if I have them here by 10:30, there would be ample time. Mr. [258] Wild certainly won't finish with four of them in an hour.

The Court: Ten-thirty you suggest?

Mr. Pratt: That was my suggestion, that I have them here by then, or eleven o'clock.

The Court: Well, make it 10:30.

(The Court adjourned at 4:10 p.m.) [259]

November 14, 1947

(The Court convened at 9:40 a.m.)

The Clerk: Civil No. 419, American Factors, Limited, versus Fred H. Kanne, Collector of Internal Revenue, defendant; case called for further trial.

Mr. Wild: Ready to proceed, your Honor. I must say I had a little difficulty getting witnesses last night, but I am hoping to boil this right down so that we can finish by noon. Mr. Singlehurst, will you take the stand. They are just checking something, your Honor. If I may ask your indulgence.

The Court: Yes.

Mr. Wild: I only got these witnesses a few minutes ago, your Honor. I wonder if it would be appropriate, while we are waiting for the check, to state to your Honor what this matter is? I have asked the treasurer of the Bishop Trust Company to come forward with the bank examiner's report of the condition of the Henry Waterhouse Trust Company, Limited. I have had copies made of excerpts from that report, which is the complete letter with two schedules annexed. And we would want to offer that in evidence. Are you ready?

Mr. Atherton: Your Honor, I think the whole report should be put in, the whole report of the bank examiner, not certain excerpts, if it is going to be offered in evidence. [260]

The Court: Well, the report, that is, the whole

report of the bank examiner is upon the subject of the Henry Waterhouse Trust examination?

Mr. Wild: Yes, your Honor.

The Court: I think myself that the whole report should be put in, if you are going to put in part of it, unless first the whole report is submitted for examination to your opponent and there is an agreement as to some particular part of it.

Mr. Wild: Well, your Honor, I have put in everything but supporting schedules. The summation of all the data is in the part that I have had typed up. I don't see any reason to clutter records with pages and pages of itemized valuations which aren't going to be relied on by item. And I don't see why the Court's time should be bothered by them.

The Court: But in the face of an objection to your picking out just what you might consider favorable to you, out of a report, without exposing, putting in the entire report, it certainly is an objection that should be sustained.

Mr. Wild: Well, your Honor, we don't want anything—we are exposing the whole report for examination. Would you come forward, then? (To a witness.)

The Witness: I have not completed yet.

Mr. Wild: I will state my position, your Honor. If there is anything else in the report that counsel would like to go in, that is all right. We will make copies and furnish [261] them.

The Court: Has opposing counsel examined the report?

Mr. Wild: I don't know.

The Court: Have you submitted it?

Mr. Wild: No, because this is on file in the office of the treasurer of the Territory, your Honor, a copy of it, and it is open alike to the United States Government and to ourselves.

The Court: But if he didn't know that you were going to use some part of it, why, naturally he wouldn't have any occasion to go over there and examine the entire report.

Mr. Wild: Well, he asked me about the report, your Honor, and that's what called it to my attention.

Mr. Atherton: I asked you about it?

Mr. Wild: Yes.

Mr. Atherton: It is a complete surprise to me. I don't recall that, but I am not going to contradict counsel. But it is a complete surprise to me. Otherwise, I would have inspected the records of the bank examiner myself personally if I had any idea that this was going to be offered. It is the first indication to me that there was any such proposal going to be made.

Mr. Wild: Well, your Honor, may I proceed? Because I am sure that once counsel inspects the thing he will have no objection. [262]

THOMAS G. SINGLEHURST

a witness in behalf of the Plaintiff, being duly sworn, testified as follows:

Mr. Atherton: Your Honor, before the witness proceeds, may I ask for your ruling on the admission of this partial report?

Mr. Wild: Well, I haven't offered it.

Mr. Atherton: Oh, I thought you had.

Mr. Wild: I was merely explaining while we were waiting what was going forward. I haven't offered any of it. The Judge hasn't seen it.

Direct Examination

By Mr. Wild:

Q. Will you please state your full name?

A. Thomas G. Singlehurst.

Q. And what is your present residence?

A. 4465 Kahala Avenue.

Q. City and County of Honolulu?

A. Correct.

Q. How long have you been a resident of Honolulu?

A. Forty-eight years.

Q. And what is your present position?

A. Vice-president and treasurer, Bishop Trust Company, Limited.

Q. How long have you been such officer, as treasurer [263] of the company?

A. Since 1937 or 8, I believe.

Q. As treasurer of Bishop Trust Company, Limited, do you have under your custody and con-

(Testimony of Thomas G. Singlehurst.)

trol official records rendered to Bishop Trust Company? A. That's correct.

Q. And I will ask you whether or not you have under your custody and control a bank examiner's report of the condition of Henry Waterhouse Trust Company, Limited, at the close of business December 31, 1932? A. I have.

Q. At my request have you produced the original of that report? A. I have.

Q. Will you exhibit it? Is that the true report you have in your hands?

A. This is it. (Showing a document.)

Mr. Wild: I would ask that that be marked Exhibit P-13, your Honor, be received in evidence.

Mr. Atherton: That is the entire report?

Mr. Wild: The entire report.

Mr. Atherton: You are offering the entire report?

Mr. Wild: I am offering the entire report.

(The document referred to was received in evidence as Plaintiff's Exhibit P-13.) [264]

Mr. Wild: Now, I will furnish for the convenience of counsel and Court a digest of that. And I am perfectly willing to recall to the Court's attention anything they want. You have examined this excerpt from the report which I have handed you?

The Court: What is the date of that report?

Mr. Wild: As of the close of business December

(Testimony of Thomas G. Singlehurst.)

31, '32, for that period as at the end of the year '32, your Honor.

Mr. Atherton: Your Honor, may I state that the report is dated July 20, 1933.

Mr. Wild: It was completed after the end of the year, your Honor, because otherwise it wouldn't have the year-in statements in it.

The Court: All I wanted was to get it for identification.

Mr. Wild: Yes, your Honor.

Q. I will ask whether you have checked that letter against the original report which is in evidence? A. Yes.

Q. And the schedue of statements, Exhibits A and B annexed?

A. I checked practically all of Exhibit A. I didn't complete Exhibit B.

Mr. Wild: Well, I will offer that as 13-A, your Honor, as explanatory in a shorthand method, the gist of the whole report. I think it is for the convenience of Court and counsel. [265] And then I would ask counsel at his leisure to examine the rest of the report, and if there is anything else he wants in there, all right. And if not, that we be privileged to withdraw the original report because it is an official record.

Mr. Atherton: Your Honor, I object to picking out this and offering this subsidiary statement—well, the whole report is in evidence now. If he wishes to examine the witness with respect to cer-

(Testimony of Thomas G. Singlehurst.)

tain items in the report, why, there is no objection. But I think that it is redundant to offer the supplementary statement when we have got the entire report.

Mr. Wild: Well, I am offering the supplementary statement so that we may withdraw the original report after counsel has examined it and found that he doesn't want anything else in there. And if he does, I will type it and have it copied and put in.

Mr. Atherton: Your Honor, I have to have my objection to withdrawing the original report. I don't want to be put to the task of determining forthwith just what part of that original report is——

The Court: All right. Sustained.

Mr. Wild: May we have an exception? No further questions.

(Witness excused.)

Mr. Wild: Your Honor, I am trying to cut this as short as I can. [266]

EDWARD J. GREANEY

a witness in behalf of the Plaintiff, being duly sworn, testified as follows:

Direct Examination

Mr. Wild: May Mr. Cades examine Mr. Greaney?

The Court: Yes.

By Mr. Cades:

Q. Mr. Greaney, what is your occupation or profession?

A. I am a certified public accountant.

Q. And you have been engaged in public accounting for quite a number of years?

A. In Hawaii since 1930.

Q. And in the course of your profession as a public accountant, were you ever consulted with respect to the Henry Waterhouse Trust Company?

A. I was. I was asked to do, to make an examination back in 1930.

Q. Do you recall when in 1930?

A. The latter part of November.

Q. And do you recall who engaged you?

A. I was engaged by Mr. A. W. T. Bottomley.

Q. Will you explain the nature of your engagement, what you were asked to determine?

A. Well, Mr. Bottomley called me to his office some time late in November, 1930, and told me that circumstances required that an examination be made of the books and accounts [267] of Henry Waterhouse Trust Company under circumstances whereby it had to be kept confidential and not be made public

(Testimony of Edward J. Greaney.)

that the work was being done. And I undertook that job somewhere along the latter part of November or the first part of December, and worked on it all the way through until about the middle of February; February 14, 1931, was the date of the report that was eventually made as the result of the examination, of the work that was done.

Q. Did he explain to you anything about the circumstances that made necessary the engagement?

A. Yes, he told me that a short time before that—I might first preface my remarks by saying that that is 17 years ago, and I am relying on my memory; also after having looked up, studied the report, reviewed the report and work papers—but he told me that a short time before that an additional stock issue had been put out by the Henry Waterhouse Trust Company——

Mr. Atherton: Your Honor, I think the testimony of the witness along this line is inadmissible on the ground of immateriality and irrelevancy. He has been called to the stand to testify with respect to the report he made on an examination.

Mr. Wild: No, we called him for his testimony, your Honor.

The Court: Sustained. The witness is going beyond the [268] question.

Q. (By Mr. Cades): Will you explain the problem that was put to you at the time of your engagement?

The Court: A little louder, if you please. The

(Testimony of Edward J. Greaney.)

current of air through the windows here makes it somewhat difficult for me to hear.

Q. Will you explain the problem that Mr. Bottomley presented to you for inquiry at the time of your examination?

A. Well, he presented it to me as a problem that had the appearance of the financial situation of the Trust Company that would require some special assistance to it, because of the fact that the balance sheet and statements of the company that had been shown to him indicated to him that the receivables or a substantial part of the assets were somewhat frozen; and that there were deposit accounts there, if demand was made for payment of them, the company would have difficulty meeting the demands because of the shortage of cash and the frozen condition of some of the receivables, substantial part of the receivables.

Q. In connection with your engagement, just what did you do?

A. Well, started in working somewhat on my own with the idea of trying to evaluate the assets, mostly the receivables. The principal part of the assets was receivables. After the [269] job had gone along for awhile, working by myself and reporting tentatively as I went along to Mr. Bottomley, he suggested and made arrangements whereby Mr. Wallie White of the Bishop Trust Company assisted me, worked along with me and assisted me on the work. A little further along other officials

(Testimony of Edward J. Greaney.)

of the Bishop Trust Company also worked on the valuation of the receivables.

Q. Did you have any discussions with any other people except Mr. Bottomley and Mr. White during that period?

A. Others of the Waterhouse Trust Company, you mean?

Q. Concerning the matter that you were working on.

A. Only officials of the Bishop Trust Company eventually. And Mr. Campbell of the Waterhouse Trust Company.

Q. And you prepared a report as of the condition of the company at February 14, 1931?

A. Report was made as of February 14, 1931. It was based largely so far as the valuation of the assets was concerned as of January 31, 1931.

The Court: January 31, 1931?

The Witness: 1931, yes, sir.

Q. So that there was a 14-day period between the date that the plan that finally developed out of the examination was consummated and the date as of which your report was made?

A. That's right.

Q. How did you go about setting values in determining, [270] in making up your report? What was the procedure you followed?

A. Well, each type of receivables required a different type of approach to determine whether it was good or bad or doubtful. Those receivables

(Testimony of Edward J. Greaney.)

that were collateral loans that had stocks and bonds behind them, of course, we valued the bonds; we placed the value of the stocks and bonds and determined whether or not the collateral was equal to or in excess or short of the balance due on the receivables. Others that were unsecured accounts we tried to determine whether or not the individual was good for it or whether the amount involved was too big or to expect full payment from them, or the nature of the account in the first place, how it arose, whether it was a stock transaction, or loans or mortgages, and so on.

Before the final figures were put together we had the benefit of several officials of the Bishop Trust Company who were trust officers and who were familiar with the values of real estate and that sort of thing, real estate mortgages; we had the real estate appraised or attempted to place values on it ourselves as best we could.

Q. And did you reach a final estimate of what—I will reframe that. Did you reach any figure as a result of those valuations that was placed on the assets?

A. Reach a figure as to the amount of losses to be expected? [271]

Q. Yes.

A. Why, I have gone back and reviewed the work papers and the summary of the schedules that was made up, and the figure as shown there is the

(Testimony of Edward J. Greaney.)

total of a column that is headed "losses" equals to a million five hundred odd thousand dollars.

Q. And did that include any figure for a loss on the Shingle and Campbell transactions?

A. That was the figure based on the January 31st balances. And that figure included something like \$727,000 in the loss column representing receivables against Shingle and Campbell. Between them and February 14 the Shingle and Campbell accounts were cleared up by the payment of cash, according to the figures there, and I think it shows in the report of some \$635,000. So that the eventual loss, the actual loss sustained in the Shingle and Campbell account was something short of a hundred thousand dollars; whereas the original figure included in the million and one-half loss was seven hundred twenty-seven thousand dollars.

Q. And the actual known loss on the Shingle and Campbell account was known before February 14, 1931?

A. The loss was, the actual loss was known and shows in the report as \$98,900 odd.

Q. Now, then, taking those figures of losses, how was the figure of one million and eighty thousand odd dollars, which is shown as the reserve on your statement of February 14, [272] 1931, after reorganization, as shown——

Mr. Atherton: Excuse me. Your Honor, don't you think that the report of the auditor should be in evidence so that you can examine it and see what

(Testimony of Edward J. Greaney.)

Mr. Cades is talking about? I mean, he is reading from papers in his hands. There is nothing before you.

Mr. Cades: If your Honor please, I was just about to identify the record that I am looking at, which is an excerpt from the report. We have stipulated to certain portions of the report of Mr. Greaney that we deemed material in this issue. And that is already in evidence as Exhibit K of P-11, attached to P-11.

Mr. Atherton: Well, all I am trying to make clear to your Honor is so that you can see what he is talking about. I think if you will refer, your Honor, to that exhibit in the stipulation, perhaps it will enable you to follow the testimony. It is Exhibit A referred to in stipulation 2. It is Exhibit P-11; stipulation No. 1, Exhibit A.

Mr. Cades: Exhibit K attached to P-11.

The Court: Yes.

Mr. Cades: May I withdraw the question?

The Court: Entitled "Henry Waterhouse Trust Company Balance Sheet"?

Mr. Cades: That's correct.

The Court: I assume that that has emanated from the [273] Waterhouse Trust Company and is a true reflection of the state of the accounts on their books on that day.

Mr. Cades: That is correct, your Honor. That has been so stipulated.

Mr. Atherton: Your Honor, if you will look at

(Testimony of Edward J. Greaney.)

Exhibit A attached to that stipulation, I think you will understand the testimony more clearly. He is talking about an item now, estimated losses of \$1,080,803.15. I don't think it is too clear from the examination of the balance sheet, because that item of losses doesn't appear on the balance sheet. A loss is a nominal account and not a real account, and the balance sheet represents the real accounts.

The Court: Is this the balance sheet that the witness made up from the books?

Mr. Cades: This balance sheet——

The Court: Where did this come from?

Mr. Cades: Exhibit K was made up from the reports and the books of the Henry Waterhouse Company.

The Court: By whom?

Mr. Cades: Well, that I don't know. I believe that was made up at the request of the Government and furnished to them in some prior cases. And those, I believe, appear in the report of cases before the Court of Tax Appeals.

The Court: Well, this is not the work of Mr. Greaney?

Mr. Cades: Well, it is prepared from information, from [274] information supplied by him. It is just another form of his own reports. In any event, I believe that Mr. Greaney as an expert could testify as to what the figures mean.

The Court: Yes. Well, that is all right. Go ahead unless there is some objection.

(Testimony of Edward J. Greaney.)

Mr. Cades: But to indulge counsel for the Government, I will refer Mr. Greaney to Exhibit A where a figure of \$1,080,803.15 appears as estimated losses.

The Court: Where does that appear?

Mr. Cades: That is in Exhibit A, your Honor, of the same Exhibit P.

Q. That is a copy of your Exhibit A, of the audit report you made as of February 14, 1931?

Mr. Atherton: Your Honor, if you will allow me to help you on this, if you will look at page 4, the stipulation of facts, you will find in paragraph 5 that Mr. Cades is talking about, Exhibit A mentioned in there which is Exhibit A annexed to the stipulation, that is the part taken from Mr. Greaney's report, audit report. It was Exhibit A attached to his report. And that is the picture for you to follow.

The Court: Now, you are examining him on Exhibit A or Exhibit K?

Mr. Cades: Exhibit A. And I will ask him later, if your Honor please, to tie that in with Exhibit K, to show what the connection is and how this was later reflected on [275] the books.

The Court: Well, now, as I got it, this balance of estimated losses against reserve, \$779,717.23, was arrived at, that estimate was arrived at by depreciating the tables concerning the debit of Shingle and Campbell?

Mr. Cades: That is correct.

(Testimony of Edward J. Greaney.)

The Court: To a very large extent? That they made that good to the extent of some six hundred some odd thousand dollars?

Mr. Cades: That's correct.

The Court: All right.

Mr. Cades: And I would now like Mr. Greaney to explain how the figure of \$1,080,000 odd was arrived at as shown on Exhibit A attached to P-11.

The Witness: Exhibit A, as I see it here, looks to me like it is an exact copy of what was Exhibit A in my report, as Government counsel said. So that the figures are identically the same. Now, then that million and eighty thousand dollars is, as it is shown there, somewhat of a balancing figure to make up the one million eight hundred fourteen thousand dollars which is the difference of it, or the one million and eighty is the difference between the one million and eight hundred fourteen thousand and the seven hundred thirty-three thousand dollars representing the Shingle and Campbell account. Now, then, the one million-eight hundred [276] fourteen thousand dollars, according to my work papers, is made up first of the million five hundred forty-eight thousand dollars about which I just testified, plus approximately two hundred sixty thousand dollars more that was added in there to make these figures balance out, for two reasons: one being that between the January 31st scheduled preparation and the February 14, 1931, Shingle and Campbell had paid in the six hundred thirty-five thousand

(Testimony of Edward J. Greaney.)

dollars for one thing; also, in making up the balance sheet of February 14th we had to take into account that there was an operating, that the company was operating and had gone on from January 1st to February 14th and during that period the books reflected a loss of ten thousand one hundred forty-nine dollars.

Now, then, going back to the million and eighty thousand dollars, that is the figure which—the four hundred thousand dollars paid in by the note holders, after that would be paid in and added to the six hundred eighty thousand dollars, that shows as the net worth on the balance sheet, would make up the one million eighty thousand dollars.

Q. In other words, do I take it that the loss, the estimated loss was raised in order to wipe out any equity above the actual estimated losses?

A. The contingency——

Mr. Atherton: Your Honor, that is a leading question. I move that that be stricken and that he rephrase the question. [277]

Q. (By Mr. Cades): Mr. Greaney, you mentioned a figure of two hundred sixty thousand dollars being added to the estimated loss. Will you explain what that two hundred sixty thousand odd represented?

A. The two hundred sixty thousand dollars represented a cushion in effect and had the effect of being a cushion to take care of any losses over and above the amount that was put in the loss column

(Testimony of Edward J. Greaney.)

on the schedule that was prepared covering the individual receivables that were on the books.

Q. And that was done for what purpose?

A. That was done because by the time we got around to preparing the final report and putting the figures together, the Bishop Trust Company had agreed to take over the operation of the Waterhouse Trust Company and had changed its position somewhat from a position it had taken somewhat shortly prior to that time, that they would pay something for the stock. And as it finally turned out, they refused to pay anything for the stock so that the reserve for contingencies was made to balance up so that it would appear proper to pay nothing for the stock.

Q. In setting the loss figures for the assets, what kind of policy was followed? Were you conservative? Were you liberal or what were the loss figures set?

Mr. Atherton: That calls for a conclusion, your Honor. [278] I move that that be stricken.

Mr. Cades: If your Honor please, it may have been a conclusion but this is the man that did the job. And he can tell us how he evaluated these figures, what kind of policy he actually used in determining the figures that were set down for this purpose.

The Court: Well, then, let him tell.

Q. Do you understand the question?

A. I wish you'd repeat the question.

(Testimony of Edward J. Greaney.)

(The reporter read the last question.)

The Court: I don't like the question in its form. You made a suggestion that the question is leading. If it is intended to inquire from the witness what method he used, that would seem to be all that is necessary to the question. What you want to get at is what method did he use in arriving at his valuations.

Mr. Cades: That is correct.

The Court: You may answer.

A. All of the receivables, and all of the other assets, were listed on schedules, long sheets, columnar sheets, and we attempted to put each individual balance in one or more columns on the schedule, based upon our valuation of it from the standpoint of its collectibility. Those items that were considered as uncollectible in full were put in the loss column. Those items that were considered as collectible in [279] part and then collectible in other part, the amount was split up and put—and the amount that would represent what we considered as uncollectible was put in the loss column. As we went along, of course, there were, of course, hundreds of these accounts and we had, of course, to change our views as we went along. The work progressed all the way from the latter part of November until some time early in February, 1931.

We had occasion, of course, to change our opinion on some of the accounts as additional information

(Testimony of Edward J. Greaney.)

was developed. However, as the valuation was being supervised, or at least I was working along with officials of the Bishop Trust Company who were eventually going to take over and did take over the operation of the Waterhouse Trust Company, and some of the officials were very severe in their views of the collectibility of these accounts to such an extent that we frequently had long knock-out and drag-out fights with them, so the eventual figure that showed on the loss column was the best judgment of all concerned but no doubt was influenced by the officials of the Bishop Trust Company in their views of trying to have them appear as great as possible.

The Court: As great?

The Witness: As great as possible.

The Court: The losses?

The Witness: The losses to appear as large as possible. [280]

The Court: I thought that's what you meant but I didn't quite get it.

A. (Continuing): One of the officials of the Bishop Trust Company, however, leaned in the other direction, leaned with me.

Q. Mr. Greaney, you mentioned a figure of ten thousand odd dollars as representing an operating loss from January 31st to February 14th, 1931. Will you explain that figure further?

A. Well, I have gone and reviewed my report and there is a schedule in my report that covers it.

(Testimony of Edward J. Greaney.)

Also the narrative part of the report explains that that represents the excess of the expenses for the month and a half, the excess of the expenses over the income as recorded on the books. But it wasn't customary for the company to accrue income, principally interest and dividends by the month. So I didn't accrue it for the purposes of this report. They followed the policy of accruing the interest and other income quarterly. So that the income as stated, or the income figures that were used that resulted in the ten thousand dollars operating loss undoubtedly were understated by all of the accrued income for the period of a month and a half. And the ten thousand dollars represents the excess of the expenses over the income. But the income not having been accrued.

The Court: Well, you say the income not having been [281] accrued. The income was accruing, was it not, but it wasn't credited?

The Witness: Yes, sir, that's what I mean, Judge.

Q. It wasn't set up?

A. It wasn't set up on the books.

Q. And you only used the figures on the books?

A. That's right.

Mr. Cades: That's all.

Mr. Wild: Might I ask a question? Are you going to examine this witness very long?

Mr. Atherton: Well, I can't tell that.

Mr. Wild: Mr. Castle is a very busy lawyer. If he can come up—I promised if possible, and if it

(Testimony of Edward J. Greaney.)

was agreeable to counsel and the Court, with the Court's permission, I would put him on as soon as he got here.

Mr. Atherton: Suppose I take only about 15 minutes.

Mr. Wild: No, I want you to take whatever time you want. Counsel evidently doesn't want to yield.

Mr. Atherton: Well, my idea is that it is fresh in my mind and I might as well proceed.

Mr. Wild: Very well. I wanted to live up to my promise to Mr. Castle.

Mr. Atherton: I understand. I don't think I am going to be very long. [282]

Cross-Examination

By Mr. Atherton:

Q. Mr. Greaney, will you tell the Court, please, what information you had and those with whom you conferred in evaluating these various asset accounts of the Waterhouse Company as to the uncollectibility of the loans, and so on?

A. We had all the records of the Hawaiian Trust Company plus the combined experience of several Bishop Trust Company officials, and we also consulted with Waterhouse Trust Company officials. One of the men, Mr. W. A. White, who worked a great deal on it, was very familiar with the accounts of the Waterhouse Trust Company, he having been an employee previously of the Waterhouse Trust Company.

(Testimony of Edward J. Greaney.)

The Court: At that time he was an employee of the Bishop Trust Company?

The Witness: Yes, your Honor. But he had previously been a Waterhouse Trust Company employee.

Q. Did you actually talk with the debtors and look into their personal situation, financial situation, each and every one of them, to determine the possibility of collectibility independently of the opinion expressed to you by the Bishop Trust Company officials?

A. Not all of them, Mr. Atherton. We did consult with the debtors in some cases, particularly in the cases of those accounts that had very large balances or comparatively large [283] balances. We did not confirm, actually confirm all of the balances of the small accounts.

Q. What did you do with respect to the collateral?

A. We determined the value of all the collateral; where the stocks were listed stocks, we used the market quotations; where they were not listed stocks, we used whatever information we could get.

Q. As to real estate mortgages, how did you arrive at the value of the property behind the mortgages?

A. We had in some instances, we went and looked at the property ourselves. In some instances, in most instances, where there was need for so doing, we had real estate appraisers of either the

(Testimony of Edward J. Greaney.)

Waterhouse Trust Company or the Bishop Trust Company, and I think one or two instances independent appraisers give us their opinions on the value of the real estate.

Q. Did they render written appraisals or just oral appraisals?

A. I don't think we had much in the way of written appraisals. This was a pretty rush job and also during part of the period was a confidential job that required caution with respect to having it known that the work was being done.

Q. Now, as to local securities other than those listed on the New York Stock Exchange and other than those dealt with over the counter, how did you arrive at their approximate [284] fair market value on the date when you made your examination?

A. Well, I couldn't say specifically at this late date. We did the best we could; which means getting financial statements whenever it is possible, talking to people who are familiar with the financial affairs of the particular company, whenever that was possible. We had access, however, to information from people who were in the position to know a great deal about the business affairs of places around town. We had access to the officials of the Bishop Bank and the Bank of Hawaii, and we consulted freely with them.

Q. Now, with respect to these demand accounts that were outstanding, did you, did anyone determine for you, any lawyer advise you, or did you

(Testimony of Edward J. Greaney.)

determine yourself as to whether the statute of limitations had run against any of those accounts as to their collectibility?

A. I don't remember that we had that particular problem. I might say that at least two of the Trust Company officials who worked with us on it were lawyers.

Q. Do you know whether or not any of these debtors waived the statute and gave such consideration that would follow it?

A. I don't recall——

Mr. Wild: I object to that. He assumes something that is not in evidence. There is no evidence that any of these were—— [285]

The Court: Overruled.

A. I don't recall any instance where a question with regard to the statute of limitations arose. It may have, but I don't recall any question of that kind or any question on that particular point.

Q. Now, would you say, Mr. Greaney, that as a result of your investigation in 1931 that the Henry Waterhouse Company was insolvent?

A. That would be a difficult question to answer at this time. I will say that my impression at that time was that it was not insolvent.

Q. What was the basis of that impression?

A. The basis of that impression was that the value of its assets, as appeared to us by different summaries that we made as we went along, exceeded

(Testimony of Edward J. Greaney.)

the liabilities. That is my understanding of insolvency.

Q. Do you know whether or not the Territorial bank examiners had made an examination of the accounts of the Waterhouse Company in 1930 or 1931?

A. I don't recall, Mr. Atherton. I have a vague recollection of some point about the bank examiner in the picture, but I don't recall as far as I know. I had no contact with the bank examiner.

Mr. Atherton: That's all. Thank you, sir.

Mr. Cades: That's all. [286]

(Witness excused.)

Mr. Wild: Mr. Castle, will you take the stand. Thank you, Mr. Greaney.

ALFRED L. CASTLE

a witness in behalf of the Plaintiff, being duly sworn, testified as follows:

Direct Examination

By Mr. Wild:

Q. Your name is Mr. A. L. Castle?

A. Alfred L. Castle.

Q. And you are a resident of Honolulu and have been for many years? A. That's right.

Q. And are one of the leading members of the Bar of this and other Courts of the Territory?

A. I deny that but I am a member of the Bar.

(Testimony of Alfred L. Castle.)

Q. And you have been for many years last past?

A. Yes.

Q. And you were at one time a stockholder in the Henry Waterhouse Trust Company, Limited?

A. That is correct, yes.

Q. And did you have any connection of any kind or sort with conferences with Mr. A. W. T. Bottomley concerning the Bishop Trust Company acquiring the capital stock of Henry Waterhouse Trust Company? A. I did. [287]

Q. And where were those conferences held?

A. The talks I had with Mr. Bottomley were down in his office there at American Factors. I mean, speaking of the 1930 conference.

Q. Yes. About when did those start?

A. They started as far as I was concerned some time in the month of November of 1930.

Q. I see. And just prior to that had there been any change in the capital stock of the Henry Waterhouse Trust Company?

A. Yes, we increased the capital stock. I think it was doubled, as I remember it. And at any rate, we paid in pars for our new stock.

Q. And did you take up any new stock on that new increase?

A. I did. I took up 400 shares, paid in four hundred thousand dollars.

Q. And that was in the middle of October, before that?

(Testimony of Alfred L. Castle.)

A. It was in October, immediately prior to the November I speak of.

Q. Yes. And what was said at this first conference between yourself and Mr. Bottomley?

A. Well, I will have to go back just a little bit there, perhaps a good many years, but not very far. Bottomley and I talked prior to 1925, quite a bit, about the possibility [288] of the Bishop Trust and Waterhouse Trust combining in some way. And we had never got anywhere on the question of price. And so that by 1925 the conferences, the talks were discontinued. And I had promised then Mr. Bottomley that if any possibility of merger ever came out in so far as I was concerned that the Bishop Trust would get first chance. And in a way we sort of continued on from that talk. and I was——

The Court: Just a moment now. Bottomley, the reason you talked to him about that, Bottomley was a leading figure in the Bishop Trust Company, was he not?

The Witness: He was, yes, he was in the Bishop Trust, and then he was connected, of course, with the Bishop Bank in Hawaii and the Bishop Company. But he was connected with the Bishop Trust.

The Court: As well as being in the American Factors?

The Witness: That's right.

(Testimony of Alfred L. Castle.)

The Court: All right. Go ahead. Pardon me for interrupting.

A. (Continuing): And we discussed actively the Bishop Trust taking over or buying the stock of the Waterhouse Trust Company.

Q. And what time was that?

A. That was in November of 1930. And, yes, I left for San Francisco in connection with a law case on December [289] 5th, returning again the day before Christmas.

Q. Now, going back to that first conversation, was anything mentioned about price at that time?

A. Only that we talked about par. I mean a hundred dollars a share.

Q. And what was your motive at that time for suggesting the sale?

A. Well, I have been interested in this merger. Then, too, we increased this capital stock in the Waterhouse Trust Company, got in new cash into the concern. And during November, and so forth, with the large amount of demand accounts there I began to wonder about the liquidity of the Waterhouse Trust Company. And I felt that the merger with the Bishop Trust would strengthen that particular situation.

Q. Now, when you returned from the coast, did you again take up with Mr. Bottomley the question, did you take up the general question of acquisition?

A. Yes, I did. I couldn't—as I say, I got back

(Testimony of Alfred L. Castle.)

the day before Christmas and I didn't see him until some time after Christmas and the first of January.

Q. Well, what occurred at that time, if you recollect?

A. At that time apparently they had made, got some accountant, I think one was Mr. Greaney, to make an investigation of the affairs of the Waterhouse Trust Company. And Bottomley stated that they had this report and that the [290] investigation was still going on, and that he couldn't talk with me about any idea of any particular price until they had completed the investigation.

Q. Did you have further discussions with him concerning this at a later time?

A. Yes, only off and on. He was waiting that final report.

Q. Now, just prior to the time when Bishop Trust Company acquired the capital stock of Henry Waterhouse Trust Company, did you have any conversation with Mr. Bottomley relative to proposals to make loans to the Henry Waterhouse Trust Company? A. Yes.

Q. Will you recount as nearly as you can where that conference or conferences took place and about when?

A. So far as I was concerned, it was down in Mr. Bottomley's office in the American Factors. And it would have been rather shortly before February 14th. How many days or whether it was in the latter part of January, I don't remember.

(Testimony of Alfred L. Castle.)

Q. And by February 14th you mean February 14th, 1931? A. That is correct.

Q. And what was said at the meeting in reference to the proposal that money be loaned to Henry Waterhouse Trust?

A. Mr. Bottomley wanted certain people or firms or [291] corporations to put up certain amounts of money, I think totaling around \$400,000. Anyway, that was the final amount. And he hoped that my father could come in for fifty thousand. And on behalf of father, after talking it over with him, we agreed to do it. That was to be on a loan basis.

Q. Was anything expressed to you whether or not there was any chance of getting repayment of that loan?

A. Well, Mr. Bottomley having gone into the matter, said that in his opinion there was no doubt that we'd be repaid.

Q. Did you have more than one conversation with Mr. Bottomley on that score, do you recollect?

A. Probably not over one more because I felt from what his investigation, statement, that it was a good loan.

Q. And actually that loan was made by your father? A. That is right.

Q. And was a note given to your father for it?

A. Yes.

Q. And do you remember anything else that

(Testimony of Alfred L. Castle.)

was said and done prior to February 14th or the consummation of this transaction about these notes or the collectibility of them?

A. No, I don't think so. Most of my conversations were directly with Mr. Bottomley.

Q. Now, Mr. Castle, you became a director of the Bishop Trust Company, Limited? [292]

A. Yes.

Q. At that time? And you know that on February 14, 1931, Bishop Trust Company, Limited, took over all of the capital stock of Henry Waterhouse Trust Company, Limited? A. Yes.

Q. Now, you recollect that there was a letter concerning the setting up of an advisory committee to the Henry Waterhouse Trust Company?

A. Yes.

Q. And were you—well, I can state to you, it is stipulated here that you were one of the advisors to the Henry Waterhouse Trust Company committee to go over the assets of the Henry Waterhouse Trust Company and advise concerning the collection and all other matters pertaining to that. You were the Alfred L. Castle who was a member of that committee? A. That's right.

Q. And did you serve on that committee?

A. Yes, I did.

Q. And what was that service, sporadic or did you give considerable attention to the affairs?

A. No, it was more than sporadic. I couldn't give you the number of meetings that we had. But,

(Testimony of Alfred L. Castle.)

we would go in there and there would be, as I remember it, Mr. W. A. White; he had prepared a great big sheet showing the various accounts and all that sort of thing. And we would go over those every now [293] and then, when you'd have a meeting with the committee. Other times one or two of us might drop in alone and check those matters over. You see, in 1931 when the thing occurred in February we were not so worried at that time about the financial condition because conditions in Honolulu were not as bad as they became later in '32 and even into '33. And so that more serious study of the situation came later than February of '31.

Q. Now, was there a complete restudy made of the assets of Henry Waterhouse Trust Company commencing early or in 1932?

A. Yes, very intensive.

Q. And did you participate in that study or revaluation of assets?

A. Yes, very definitely because I represented my father there.

Q. I call your attention to Exhibit M annexed to P-11 in evidence in this case, and ask you to examine that exhibit. (Handing exhibit to the witness.)

A. Yes, I remember such a letter. This, of course, is directed to American Factors, but, as I remember it, there was one directed to my father also.

(Testimony of Alfred L. Castle.)

Q. And you saw such a letter? A. Yes.

Q. And you will note that letter [294] refers to the fact that early in 1932 the advisory and financial committees of this company decided that it was advisable to reappraise all its assets.

A. That's right.

Q. Do you know of your own knowledge whether that is true? A. Yes, it is true.

Q. And it is further stated,

"* * * an exhaustive reappraisal disclosed that its liabilities, other than those to the Underwriters and Stockholders, exceeded the value of its assets by a very considerable amount." A. Yes.

Q. Was that true?

A. That is true so far as we could ascertain.

Q. Then the statement is made,

"We are now quite confident, and accordingly advise you, that in our opinion the promissory note of \$50,000.00 above referred to is of no value whatever."

Did you, as a result of your study, come to the conclusion as to the value of the \$50,000.00 note in 1932?

A. Yes, I thought it was worthless and should be written off.

Q. I see. And how long a period of time was expended in these studies and reappraisals of the assets? [295]

A. Oh, a good deal of time there. Take in January, 1932, we went into those things very

(Testimony of Alfred L. Castle.)

carefully. These big sheets that we had, they would be put down "slow," "bad," "doubtful," "bad," and various designations on it. Then you'd take up that particular account and you might have other facts of your own. You might know the person, whether he was morally responsible, and whether he might have other assets somewhere or would be apt to come through. So that you took the account from all angles, not merely when it said the mortgage of \$40,000 and you found that the value of the land was twenty thousand. You didn't necessarily say that that was a loss to that extent then, but you went into the whole situation to see if there wasn't some possibility of recovery.

Q. Mr. Castle, you have been a director of Bishop Trust Company ever since? A. Yes.

Q. And you have been a member on that advisory committee ever since?

A. That's correct.

Q. Has any fact occurred since 1932 which would now cause you to change your opinion in '32 that that note became worthless in '32?

A. No, because towards the end of '32 conditions were worse and the Henry Waterhouse picture was worse than it was [296] in January of '32.

Mr. Wild: I see. No further questions.

Cross-Examination

By Mr. Atherton:

Q. Mr. Castle, you testified that you were al-

(Testimony of Alfred L. Castle.)

ways interested in a merger of the Waterhouse Trust Company into the Bishop Trust Company. Were you concerned about that and interested in effecting that merger as far back as 1930?

A. Yes, but that wasn't, there wasn't any worrying about financial reasons. The Waterhouse Trust and the Bishop Trust were two rather small trust companies. And it was just my own belief that they could be of better service to Honolulu by having a combination.

Q. You testified also that you believed the situation after 1931, say, 1932, was more serious with respect to the Waterhouse Trust Company than it was in 1931. A. I think so.

Q. What is the basis of that?

A. It was general business conditions in Honolulu. There was a—the real estate market, for instance, as I remember it now, we had real estate people come in before the committee—the real estate market was going down, conditions were getting very much harder here. For some reason or other, I don't know why, there is always a lag here in Hawaii between here and the mainland. You had your tremendous [297] crash in '29 or so. Well, it didn't hit us so bad. We were on the way down somewhat in '31, but we got into about the worst in '32 and even into '33 it was rotten, too.

Q. Now, you also testified, Mr. Castle, that you thought that the Waterhouse note was worthless in 1932 and should have been written off.

(Testimony of Alfred L. Castle.)

A. Yes.

Q. Now, Mr. Wild has shown you Exhibit M which is attached to P-11. That is the stipulation of facts; being a letter dated July 18, 1932, which you testified as being the letter that was sent to your father.

A. That's right.

Q. Do you know whether or not your father formally wrote any communication to the Waterhouse Trust Company notifying them that he had conceded that the note was worthless in that year?

A. No.

Q. Have you any knowledge as to why he failed to do so?

A. No. For instance, when it came to the 1932 income tax return, we claimed then a loss of the note; I mean on behalf of my father, a loss of the note during that calendar year '32. I was one that felt all along that the thing was gone. I didn't care what the others did. Then later on, whether it was '33—it was '33, I think—there was some sort of a meeting there by which they sort of carried on with the [298] assets tagged, and so forth, and the majority of us voted to do that. But in my opinion there was no—the note was worthless, or I wouldn't have made the claim.

Q. Primarily why did your father fail to comply with the request contained in that letter of July 18th?

A. Some of the others didn't, and I don't know of any specific reason why he didn't, no.

(Testimony of Alfred L. Castle.)

Q. Do you know whether or not in 1932 the merger of the Waterhouse Company into the Bishop Trust Company that was effected in 1933 was under discussion between the officials of both companies and whether or not the note holders had knowledge of that prospective merger?

A. That thing I honestly don't remember, no. Just what the fact was, I do not remember.

Mr. Atherton: That's all. Thank you, Mr. Castle.

(Witness excused.)

Mr. Wild: No further evidence, your Honor. So far as American Factors is concerned, we rest.

The Court: Well, you put in that Territorial bank examiner's report.

Mr. Wild: Yes, your Honor. I'd like to read it.

The Court: For what purpose?

Mr. Wild: Well, I want to read it.

The Court: Is there anything in it?

Mr. Wild: Yes, your Honor. [299]

The Court: If you want to expose it to the Court——

Mr. Wild: Yes, if you'd rather I do that than examine the witnesses on the stand. You called the A. and B. case. They want to put on the evidence on this note. They've got witnesses. But I would like to call this to your Honor's attention.

The Court: Before you close, if there is anything in there that you want me to know about——

Mr. Wild: Yes, there is.

The Court: And you will stand aside for A. and B.?

Mr. Wild: Yes, I will. I meant to read this to your Honor before closing.

The Court: It is time for a recess.

(A recess was taken at 10:50 a.m.)

After Recess

Mr. Pratt: If your Honor please, in Civil Action 474, which is the proceeding by Alexander and Baldwin, Limited, we'd like to present to the Court——

The Court: What is the number?

Mr. Pratt: 474. We'd like to present to the Court a stipulation, stipulation 1.

The Court: You've got two stipulations?

Mr. Pratt: No, your Honor. But we just followed the same procedure as in the other matter. This stipulation one, your Honor, is identical with the one presented by American [300] Factors as stipulation one, the Exhibit P-11 in the other civil matter, with the exception of the first two paragraphs and paragraphs 24 to 27 inclusive. The differences with respect to paragraph 2, your Honor, are merely that this is Alexander and Baldwin, Limited, rather than American Factors. And the figures have been changed to represent those of Alexander and Baldwin. Counsel is willing, I believe, to agree that he has no objection to this stipulation except insofar as paragraph 2 is con-

cerned, that he makes the same objection that was made to the American Factors' paragraph 2.

And also with respect to paragraph 19, your Honor, that he makes the same objection there with respect to Exhibit M that he does not want it considered as stating facts that are true but will admit it to be the copy of the letter addressed to Alexander and Baldwin.

The Court: Yes.

Mr. Pratt: With respect to the paragraphs 24 to 27, your Honor, paragraph 24 merely states the method which Alexander and Baldwin kept its books and differs in that respect from the American Factors.

The Court: Kept on a cash basis?

Mr. Pratt: That's right, your Honor.

The Court: Well, that would mean that—yes, every year stands on its own bottom. [301]

Mr. Pratt: Well, your Honor, we have certain matters which we intend to have explained to the Court today with respect to the returns for '31 and '32. The next paragraph——

The Court: I think in passing now you had better elucidate that cash basis of accounting, just precisely what you mean by that.

Mr. Pratt: Your Honor, I'd rather have the witness explain, if I may.

The Court: All right.

Mr. Pratt: Paragraph 25, your Honor, shows the journal entries that were made with respect to this note. Paragraph 26 just refers to what

happened in the year '32 and is similar to the paragraph in the American Factors' suit. And paragraph 27, your Honor, concerns another deduction taken by Alexander and Baldwin, Limited, with respect to a thousand dollars contribution of Hawaii Bureau of Governmental Research. I don't know whether the Court desires to have that read or whether we may proceed without having that read.

The Court: Well, I am reading that now. This bureau was organized under laws of the Territory. It is rather lengthy. You had better read it.

Mr. Pratt: "In the year 1932 the Plaintiff contributed to the Hawaii Bureau of Governmental Research \$1,000. This bureau was organized under the laws of the Territory of Hawaii in 1928 by representatives of local business firms, and [302] membership was available to any taxpayer of Hawaii upon contribution of not less than \$10 a year.

"In operation, the Bureau of Governmental Research offers, and during the entire calendar year 1932 it also offered, gratuitous advice and assistance to the Governor of the Territory and governmental bureaus and agencies, usually at their request; studies and devises plans designed to effect efficiency and economy in governmental administration; analyzes proposed legislation and makes recommendations thereon to the territorial legislature; and supplies interested organizations, such as churches, chambers of commerce, and groups of citizens, with information and counsel on proposed leg-

islative measures. The bureau has no political aspects. Typical of the bureau's activities are a survey and suggested revision of the administrative organization of Maui County made in 1933 and an analysis of income tax returns made in 1934 at the request of an advisory committee on taxation to determine the ability to pay of various taxpayers.

"The bureau is supported entirely by its members' voluntary contributions which range from \$10 to \$10,000 a year. An attempt is made to interest all of the people of the Territory of Hawaii in the bureau and make it a citizens agency. Contributions to the bureau are made by corporations, individuals, and chambers of commerce. Definite amounts are [303] requested of the several members, apportioned on the basis of taxes paid, but each member is free to give what he wishes, and some members contribute at intervals longer than a year, or sporadically. About 75 per cent of the bureau's receipts come from corporations.

"In its federal income tax return for the calendar year 1932 the taxpayer deducted the amount of the above contribution as an ordinary and necessary business expense, and the Commissioner of Internal Revenue after investigation determined that the amount was not allowable as a deduction, for the reasons stated in his 90-day deficiency letter dated June 2, 1936."

I understand counsel has no objection to that.

Mr. Atherton: No objection to that.

Mr. Pratt: We'd like to offer this stipulation, your Honor, with the understanding that it will be subject to the same objection made by counsel, and I assume the same Court ruling.

The Court: Very well. The stipulation is received in evidence.

The Clerk: What designation shall we give this particular stipulation?

The Court: A. and B.'s Exhibit A.

The Clerk: A. and B.'s Exhibit A, Alexander and Baldwin Exhibit A. [304]

(The document referred to was received in evidence as Alexander and Baldwin, Limited, Exhibit A.)

Mr. Pratt: I'd like to call Dr. Dean. Your Honor, with respect to Exhibit M attached to that stipulation, it was noticed just as we came to court that the exhibit which is attached was a copy of the letter which was sent to Hawaiian Trust Company, Limited, rather than the letter which was sent to Alexander and Baldwin, Limited. Copies of the letter to Alexander and Baldwin are being made, and I understand that Government counsel is agreeable to the substitution of that letter in place of the Exhibit M now attached.

The Court: Yes.

Mr. Atherton: That's right.

The Court: That substitution to be Exhibit M?

Mr. Pratt: Yes, your Honor.

ARTHUR L. DEAN

a witness in behalf of Alexander and Baldwin, Limited, being duly sworn, testified as follows:

Direct Examination

By Mr. Pratt:

Q. Will you please state your name?

A. Arthur L. Dean, D-e-a-n.

Q. And you reside in Honolulu?

A. Yes, sir. [305]

Q. And have for how many years?

A. Thirty-three and something over.

Q. You are connected with Alexander and Baldwin, Limited? A. Yes, sir.

Q. And how long have you been?

A. Since July, 1930.

Q. And what position do you now hold?

A. I am a director and vice-president.

Q. When you first became associated with Alexander and Baldwin, did you hold any position?

A. Not for the first few months.

Q. When did you become a director?

A. In November of 1930.

Q. And you became a vice-president in what year? A. 1933.

Q. Now, Dr. Dean, in the stipulation the general character of Alexander and Baldwin's business is set forth. You had an opportunity to read the stipulation?

A. Yes, I looked through it.

Q. And in connection with the representation

(Testimony of Arthur L. Dean.)

of the five sugar companies and three pineapple companies, what financial arrangements are made with those principals?

A. We sell their products and receive payment therefor, the San Francisco office. We pay the bills for the purchases [306] which we make for them, which run into a number of million dollars a year. We file their tax returns and pay their taxes. And we honor their drafts for monies which they require for current operations, such as payrolls and ordinary expenses of running plantations and pineapple companies. The result of this situation is that a company may have either a credit balance or a debit balance. It makes no difference in our handling of the business, whether their accounts are on the credit side or on the debit side. There have been times at which a company's debit balance would run to over a million dollars. Ordinarily they are not as large as that. On the other hand, there will be credit balances, and we act as a sort of financial reservoir into which their income pours and out of which their needs are supplied, including, of course, payment of their dividends if they happen to be fortunate enough to be able to pay them.

Q. In the year 1930, when you first became connected with Alexander and Baldwin, what were the general conditions, financial conditions?

A. Well, at that time, in July of 1930, they were still pretty good in the Territory.

(Testimony of Arthur L. Dean.)

Q. And did they get worse or better?

A. They got worse.

Q. Did you, somewhere near that time, have anything to do with the Henry Waterhouse Trust Company matter? [307]

A. Yes, it was discussed by the manager, Mr. John Waterhouse, and assistant manager, Mr. Charles Hemenway, with the directors of the company, and informal approval was given for making a loan of \$50,000 and that informal approval was confirmed and ratified at the next regular meeting of the directors. I don't remember now whether the practice, which is fairly common, of circulating a resolution with places for the directors to indicate approval or disapproval, whether that was followed in this particular instance or not.

Q. Now, Mr. Waterhouse and Mr. Hemenway of whom you speak, are they living?

A. No, they are both dead.

Q. They held what positions?

A. John Waterhouse was the manager and Charles Hemenway was assistant manager.

Q. In those discussions which you had with Mr. Waterhouse and Mr. Hemenway, was anything said with respect to this, to the repayment of this loan?

A. I don't recall anything specific having been said about repayment.

Q. Did they state or did you discuss with them the reasons for making the loan? A. Yes.

Q. What were those reasons?

(Testimony of Arthur L. Dean.)

A. There were two basic considerations. The Waterhouse [308] Trust Company was very obviously in a dire need of liquid assets to meet obligations, and we had two things in mind really. One was the saving of the investments and monies of innocent persons who had placed their funds in the care of the Waterhouse Trust Company in one way or another. The other consideration was the maintenance of the integrity and stability of the basic business enterprises of the Territory. We are a rather closely-knit community and small and isolated. And Alexander and Baldwin has always stood for stability and integrity and we felt very strongly that it would be a major disaster, the ramifications of which could not be foreseen, if one of the trust companies went bankrupt and was unable to meet its obligations.

Q. Alexander and Baldwin, Limited, had no financial interest in the Henry Waterhouse Trust Company? A. No, sir.

Q. At the time this loan was made, the company received a promissory note, did it not, for payment? A. That's correct.

The Court: Well, that is a note that is set out in the exhibit?

Mr. Pratt: It is in the exhibit, your Honor.

The Court: Exhibit N?

Mr. Pratt: Exhibit N attached to A. and B.'s Exhibit 1.

(Testimony of Arthur L. Dean.)

Q. I show you a note, Dr. Dean. That is the original [309] note, is it not?

A. Yes, sir.

Q. In connection with this loan? Dr. Dean, are you familiar with any other instance such as this where Alexander and Baldwin made an offer to loan money to other institutions at about that time?

A. Yes, sir. The Hawaiian Pineapple Company got in pretty desperate straights and there were rumors that it might go bankrupt, and in our opinion that would be a major disaster of far-reaching consequence in the pineapple industry in which we were interested, and in the total over-all business situation of the Territory. And at that time our directors authorized the management to offer to advance five hundred thousand dollars to Castle and Cooke to help refinance the Hawaiian Pineapple Company.

Q. Was that offer made?

A. That offer was declined because they found they had sufficient resources to handle the reorganization within their own group.

Q. Dr. Dean, with respect to the claim for the deduction of the Hawaii Bureau of Governmental Research, you have read or heard read here in court also the paragraph concerning the stipulation of facts?

A. Yes, sir.

Q. While you were associated with Alexander and Baldwin, [310] Limited, did you have anything to do with the Hawaii Bureau of Governmental Research?

A. Yes, sir.

(Testimony of Arthur L. Dean.)

Q. What did you do?

A. Well, there were two projects, the projects of the Bureau, in which I was particularly concerned. One was the matter of classification of Territorial employees and the setting of salary schedules with respect to which Mr. Goddard conferred with me.

Q. May I interrupt? Who is Mr. Goddard?

A. Mr. Goddard was the director of the Hawaii Bureau of Governmental Research. The other matter had to do with the framing of the two acts which were intended to tie this Territory into the social security legislation of the Federal Government, one the Unemployment Compensation Act and the other the Public Welfare Act. I was chairman, I believe, of the small committee that drafted the original Unemployment Compensation Act. And I also worked with others in connection with the Public Welfare Act.

Q. Now, in your work with that Hawaii Bureau of Governmental Research, who did you represent?

A. Well, strictly speaking of course, I represented Alexander and Baldwin, but indirectly represented the plantation and pineapple companies for which Alexander and Baldwin is agent. That is a very common situation in our organization, where a matter may have comparatively small importance to Alexander and Baldwin itself, but be-

(Testimony of Arthur L. Dean.)

cause of the obligations we assumed as agent for the companies we carry on pretty extensive operations.

Q. Did Alexander and Baldwin, Limited, or its companies reap a benefit by the work of the Hawaii Governmental Research?

A. I believe they did.

Q. In what way?

A. Well, there are two sides to this matter. One is the—you might call the income side, which is related to taxation. And the other the expenditure side, which is related to the efficient expenditure of the funds which are collected by Government through taxation. They are both parts of the same problem, namely, the providing of services through Government for the benefit of the people and the payment by the people for those services. So that whenever the activity of the Bureau impinged either on taxation on the one hand or on Government organization and operation, it had a direct value to all of the taxpayers of the Territory, including Alexander and Baldwin and the companies which it represents.

Mr. Pratt: That's all, your Honor, of this witness.

Cross-Examination

By Mr. Atherton:

Q. Dr. Dean, do you know whether or not the \$50,000 [312] note was actually paid by the Waterhouse Company?

(Testimony of Arthur L. Dean.)

A. You say, was it paid?

Q. Yes. A. No, sir.

Q. Do you know whether or not Alexander and Baldwin made any formal reply to the communication referred to in the Plaintiff's Exhibit A as Exhibit M, being the copy of the letter dated July 18, 1932, addressed to the taxpayer by the Henry Waterhouse Trust Company, in which it suggested that the Alexander and Baldwin concede the worthlessness of the note by formally authorizing the Waterhouse Company to consider that it is no longer an obligation; do you know whether there was any formal reply made to that letter?

A. No, I do not.

Q. Did you have occasion in 1931, prior to Alexander and Baldwin's making the \$50,000 advance to the Waterhouse Company, to inquire into the financial condition of the Waterhouse Company at that time?

A. I don't remember whether I saw and studied the balance sheet or not. I couldn't tell you.

Q. Did you see a balance sheet of the Waterhouse Company as of February 14, 1931, immediately after the so-called reorganization of that company had taken place?

A. I couldn't answer that categorically. I am reasonably sure that I did but I certainly couldn't testify that I [313] positively, that I did.

Q. Did you form any opinion at that time, February 14, 1931, as to the prospects of repayment

(Testimony of Arthur L. Dean.)

by the Waterhouse Company of the \$50,000 advanced by your company to it?

A. Well, my understanding of it was that the whole situation of the Waterhouse Company was in a state of flux, and that perhaps all that was needed was cash right then and there to take them over the hump. And it wasn't a loan of the type which one would ordinarily make as an investment, trying to make a good investment; that wasn't the kind of an investment that we would have made. But, as I explained in my direct testimony, there were other considerations which made it seem to us worthwhile to make a loan to a company which was, as I say, in a state of flux and about whose future we were by no means sure.

Q. Well, then, you didn't form any opinion at that time, 1931, February 14, 1931, or shortly thereafter, as to the possibility or probability of repayment of that advance?

A. Well, we expected to get all or part of our money back again, but the stake in preserving the company was sufficiently large so that, as I say, we were prepared to make a loan which probably would not have been justified as a straight investment.

Q. In other words, you were more concerned with protecting the Waterhouse Company from becoming bankrupt in 1931 [314] and its possible effect on all the other financial institutions in the Territory than you were about getting repayment of the \$50,000?

(Testimony of Arthur L. Dean.)

A. Well, the basic consideration was the job to be done. As I say, we expected to get money back on our loan, but we took a risk on it.

Q. Now, in 1931, the stipulation discloses in paragraph 25 thereof, that \$25,000 of the \$50,000 advanced to the Waterhouse Company, was charged off on the books of account of Alexander and Baldwin in that year. Will you explain to the Court why you charged off, why your company charged off on its books in the year 1931 twenty-five thousand dollars of that advance?

A. No, I can't do that because I don't know.

Q. The stipulation in the same numbered paragraph also shows that in the following year, 1932, there was charged off \$25,000, being the balance of the \$50,000 so advanced to the Waterhouse Company. Can you explain to the Court why in the year 1932 the \$25,000 was charged off the books?

A. Well, we figured we were in the position of the fellow on the 17th tee with three down.

Q. I'm afraid that doesn't convey any information to me.

A. Well, the point I am making is that you may not have played the thing clear out to the end, but you reach a [315] point when you know that as far as you are concerned you are licked.

Q. Now, in 1932 when your company charged off this \$25,000, what were the facts upon which you concluded that you were partially licked with respect to collecting the note?

(Testimony of Arthur L. Dean.)

A. I don't remember, sir.

Q. So you want the record to show, then, that in 1932 that your company believed it was only partially licked with respect to the collectibility of this note?

Mr. Pratt: Your Honor please, that isn't his testimony.

Q. I am asking you, do you want the record to show that?

The Court: The question is permissible. As I get it, the note as a loss was written off in two amounts, twenty-five thousand in one year and twenty-five thousand in the next year. And the question, as I see it from the testimony, is that they finally determined that they were licked. And the question was, would they determine they were half-licked when they wrote off twenty-five thousand.

Mr. Pratt: But he said in 1932, your Honor. I want to make sure of the year he is talking about.

Mr. Atherton: I am talking about 1932. Read the question.

(The reporter read the last question.) [316]

A. No, sir.

Q. What do you want the record to show?

A. Sir?

Q. What do you want the record to show?

A. That by the end of 1932 we were convinced we were completely licked.

(Testimony of Arthur L. Dean.)

Q. Then will you explain for the Court or to the Court why you only wrote off in that year 1932 one-half of the amount of the note, of the face amount of the note?

A. Doesn't the record show, sir, that the other half was written off the year before or at least the reserve set off to write it off.

Q. Would you say that the charge-off in the prior year, 1931, of one-half of the face amount of that note represented a determination by your company that in the year 1931 it had concluded that only one-half of the note or that one-half of the note had become worthless there?

A. Well, you are calling on me for a conclusion, and all I can say in answer to it is that the officials of the company so determined.

Q. Now, in 1932, Dr. Dean, do you know whether or not, or did you participate in any discussions respecting a contemplated merger of the Waterhouse Company into the Bishop Trust Company?

A. Oh, I knew about it, but I didn't participate in [317] the negotiations or the discussions.

Q. Did you communicate your knowledge of that prospective merger to any other officials or directors of your company in 1932?

A. I couldn't tell you, sir.

Mr. Wild: Just to keep the record straight, your Honor, that wasn't even thought of in 1932. The record shows it didn't come up until 1933.

Mr. Atherton: Your Honor, I'm afraid that Mr.

(Testimony of Arthur L. Dean.)

Wild is out of order. He is attempting to testify.

Mr. Wild: I want to keep the record straight in this case, and we have already stipulated when the merger took place, and counsel is misstating what we have stipulated to.

Mr. Atherton: I'm sorry, your Honor. I am not misstating anything whatsoever. Mr. Wild would like to make it appear that I am making misstatements. I think he should be confined to when he has the floor. The record shows the stipulated fact that the merger took place in 1933; that a letter dated I think some time in December, December 19, 1933—I am not quite sure—was sent out to the noteholders asking them to consider one or two proposals. And they adopted one of the proposals and included the other. What I was trying to bring out through the witness was whether or not prior to 1933 the noteholders had any knowledge of the possibility of a merger. And the very obvious reason of my question [318] goes to this, that if they had knowledge of a prospective merger that was going to take place either that year or a subsequent year, there was reason for them to believe that following the merger of the Waterhouse Company into the Bishop Trust Company that as a matter of law all the liabilities of the Waterhouse Company would be assumed, become obligations of the Bishop Trust Company; and that therefore they had a reasonable basis for believing that after such a merger, if contemplated,

(Testimony of Arthur L. Dean.)

was accomplished that they would be able to collect the face amount of their note.

The Court: Not unless it were realized out of the assets of the Waterhouse Trust Company.

Mr. Atherton: True.

The Court: Well, proceed.

Q. (By Mr. Atherton): Now, coming to the contributions which Alexander and Baldwin made to the Hawaii Bureau of Governmental Research in 1932, will you please state to the Court whether or not your company received any direct benefit as a result of that contribution?

A. I know of no direct benefit, no, in dollars and cents.

Q. Would you say, then, that your company's interest in making that contribution was merely with the expectation, together with all taxpayers, that it might generally benefit as a result of the activity of the Hawaiian Bureau of Governmental Research?

A. Well, in general the Bureau of Governmental Research was not directing its efforts to helping specific companies, you understand, but to more generalized situations. And insofar as they were successful with reference to those, we participated in the success, benefitted thereupon.

Mr. Atherton: That's all. Thank you, Doctor.

The Court: Who, Doctor, organized the Governmental Research and sold the idea to the business community, do you know?

(Testimony of Arthur L. Dean.)

The Witness: You say, who did it?

The Court: What?

The Witness: Did you ask who did it?

The Court: Yes.

The Witness: I don't remember the names of the individuals. They are probably of record.

The Court: You don't remember how it came about that it was organized?

The Witness: I think it was talked up in a comparatively small group at first, and other persons were interested until there were enough of them interested to put up enough money to get the thing launched.

The Court: All right.

Q. (By Mr. Pratt): Dr. Dean, in connection with your cross-examination on [320] these contributions, Governmental Research, you say that any benefits that you got would be proportionate to your contribution? The stipulation, Dr. Dean, shows that the contributions were made according to the amount of taxes that the various contributors put in. In some instances, of course, they did give more or less than that. That was the plan.

Mr. Atherton: Your Honor, I think that question is objectionable. It calls for a conclusion from the witness. He has already testified that they received no direct benefit.

Mr. Pratt: It doesn't have to be direct, your Honor, in our interpretation of the cases. Also, the Government's own position more recently—

(Testimony of Arthur L. Dean.)

The Court: I just lost track of the exact wording of the question.

(The reporter read the last question.)

The Court: Well, I don't get what the question was.

Mr. Pratt: It's at the very beginning, your Honor. My question was, I asked him whether the benefits that they got, which they received, were proportionate to their contributions.

The Court: Oh, if you can answer that, you may.

The Witness: I don't think I can, your Honor.

The Court: All right.

Mr. Pratt: I have no other questions.

(Witness excused.) [321]

Mr. Pratt: Does the Court desire to start on our last witness?

The Court: I think so. He will be a short witness, I take it.

Mr. Pratt: I think so.

CARL R. LINDEN

a witness in behalf of Alexander and Baldwin, Limited, being duly sworn, testified as follows:

Direct Examination

By Mr. Pratt:

Q. Will you state your name?

A. Carl R. Linden, L-i-n-d-e-n.

(Testimony of Carl R. Linden.)

Mr. Pratt: I might state to the Court and Counsel that Mr. Linden is hard of hearing, and if I talk loudly the Court will understand.

The Court: Yes.

Q. You reside in Honolulu, Mr. Linden?

A. I do, yes, sir.

Q. And how long have you lived here?

A. Since 1919.

Q. And you are connected with Alexander and Baldwin, Limited? A. I am.

Q. And how long have you been so connected?

A. Since April, 1920. [322]

Q. Did you at any time have any connection with American Factors? A. Yes.

Q. In what capacity?

A. From 1920, from April, 1920, until the end of 1935, to the best of my recollection.

Q. And what was that connection?

A. I was tax advisor and giving certain advice in connection with accounting procedure.

Q. And you have a similar position with Alexander and Baldwin?

A. I have, and still have.

Q. And you have had that how long?

A. For 27, going on 28 years now.

Q. In connection with the Henry Waterhouse Trust Company matter, which is now before the Court, you have read the stipulation filed, have you not? A. I have, yes, sir.

Q. And did you have any connection with the

(Testimony of **Carl R. Linden.**)

matter of claiming any tax deduction with respect to the loan to Henry Waterhouse Trust Company?

A. That was my job.

Q. And did you also have anything to do with it for American Factors? A. Yes, sir. [323]

Q. In this stipulation, Mr. Linden, reference is made to the fact that Alexander and Baldwin is on a cash basis, and the Court desired to have some brief statement as to what was meant by cash basis. Would you state that?

A. That means that the transaction is not recorded until it is closed. In other words, take as an illustration, you have a bond that the interest, the dates we will say, the interest dates are September and March. On December 31st there are three months' interest accrued on that bond. In the case of an accrual where your books are kept on the accrual basis, that interest would then be taken up as part of that year's income; whereas, on the cash basis it is not taken up as income until the coupon is clipped or the interest is paid. If it is never paid, it is never taken up. That is the distinction between the cash and the accrual method of accounting. Cash method is used primarily by concerns like ours and by banks where there are no inventories or trading involved, where in the merchandising business you can't be on a cash basis because you buy goods and you carry them over from year to year.

Q. Mr. Linden, in paragraph 25 of the stipula-

(Testimony of Carl R. Linden.)

tion in evidence as A. and B. Exhibit A, I'd like to show you the items which are shown as being book entries in the year 1931, December 31, and August 8, 1932. Are you familiar with those entries? [324]

A. Yes, sir. These entries were taken from the books of original entry.

Q. And with respect to the entry for the year 1931, what have you to say with respect to that?

A. At the end of 1931 the treasurer of the company asked me if it would be all right to write down half of it, and I asked him the reason for it. He said, we had a good year. I asked him what evidence or information he had. Well, they didn't have any. I said, well, write it off, but you can't claim it is a tax deduction. So he wrote it off. And on the back of the return he made, the schedule, it is shown as a non-deductible item.

Q. I show you your office copy of return for the calendar year 1931, and refer you particularly to schedule "L," and ask you if anything is indicated there as to what disposition was made of this 1931 item?

A. Under item 13-J it is shown as reserve loss, \$25,000, which indicates or shows that it was not taken as a deduction.

Q. That \$25,000 mentioned there was the Henry Waterhouse Trust Company obligation?

A. That was the one-half that is shown in your stipulation you just showed me. That is written off on December 31, December, 1931.

(Testimony of Carl R. Linden.)

Q. And your return indicated that it was put in the reserve for loss. In the year 1932 what was done with respect [325] to the Henry Waterhouse Trust Company note?

A. The remaining \$25,000 were written off, and when we came to prepare the tax return for that year the whole amount was claimed as the deduction for bad loss.

Q. And what, if anything, did you do at that time to ascertain whether it should be written off or not?

A. Well, in the first place I took it up to Mr. Lowrey, Sherwood Lowrey, who was treasurer at that time of the American Factors. And being interested in both Alexander and Baldwin and the Factors, and having both treated the same way, we discussed it and he was on the committee, to the best of my recollection, the Waterhouse committee, to make an appraisal to ascertain the progress of the liquidation; and he was firmly of the opinion that there was no possibility of any recovery ever being made from it, from that note.

Q. Did you also have occasion to discuss the matter with Mr. John Waterhouse.

A. Oh, yes.

Q. And did he express a similar opinion?

A. He did. He said from all the reports it is lost, gone.

Q. And who is Mr. John Waterhouse?

A. He was president and general manager of Alexander and Baldwin, Limited.

(Testimony of Carl R. Linden.)

Q. And do you know whether or not he was also connected [326] with the Bishop Bank?

A. I am quite certain he was on the board of directors at that time.

Q. He subsequently became president?

A. He became president after George Rea resigned as the executive vice-president and manager.

Q. I show you a copy of the 1932 return, Mr. Linden, and also ask you to look at schedule "L" and state whether or not there is anything shown there with respect to the 1931 item?

A. Under item 4-C of the return as shown, which is on the lefthand or debit side, is shown reserve for loss, 1931, \$25,000.

Q. What was the purpose of putting that in there?

A. That was merely a reversal of a similar adjustment on the other side of the previous year's return to show that that \$25,000 was included among the deductions on this return.

Q. So that you not only wrote off on this return the deduction shown in the ledger for '32 but also the one for '31? A. That's correct.

Q. Mr. Linden, I show you the original of Exhibit "M" attached to A. and B. Exhibit A, the letter of July 18, 1932, and ask you whether you saw that letter?

A. Yes, I have seen that before. [327]

(Testimony of Carl R. Linden.)

Q. And you know whether or not that letter was received prior or after Alexander and Baldwin had written off the obligation?

A. It was received several months prior to it, of course. It was received, it's got the receiving stamp of July 18, 1932.

Q. And, Mr. Linden, the book entry in paragraph 25 refers to the write-off as having been made on August 8th. Do you know whether or not any reference was made to this letter in that book entry?

A. Yes, there was a notation made in the explanatory journal entry which referred to this letter.

Q. That reference in here this paragraph 25 referred to a letter, H. W. Company, 7/18/32. That is this letter? A. That is this letter.

Q. And following your examination of this letter, did you have any discussion of its contents, particularly the references to the fact that the note was worthless, with anybody?

A. I talked it over with Mr. Lowrey.

Q. And it was that conversation that you previously reported?

A. That is the conversation which I previously reported and which prompted us to claim it as a loss in 1932. [328]

Q. Do you know anything concerning the Hawaii Bureau of Governmental Research?

A. In a general way.

(Testimony of Carl R. Linden.)

Q. And did you have anything to do with the claim of deduction? A. Yes.

Q. And what prompted you to make that claim?

A. Because that contribution was made towards the conduct of an organization whose business it was to examine into Governmental expenditures and see that taxpayers got dollar's worth of service for a dollar's worth of taxes paid. And Alexander and Baldwin in itself had among other things between 40 and 50 million dollars worth of taxable property subject to real, personal property taxes in addition to their income taxes, and we would not have served our clients properly unless we contributed towards the support of an organization of that kind. So I couldn't see that there could be any objection at all to taking it as a deduction.

Mr. Pratt: I think that's all, your Honor.

Cross-Examination

By Mr. Atherton:

Q. Mr. Linden, did your company adopt the actual method for charging off bad debts or the reserve method for charging off bad debts?

A. During the 27, going on 28 years, that I have been [329] with the company, that is the only occasion I can recollect where we ever had any bad debts. We kept pretty clean records down there.

Mr. Wild: No experience.

The Court: Never took another chance?

(Testimony of Carl R. Linden.)

The Witness: No, sir. If you get anything out of what you have got, you have got to be good.

Q. So, then, in 1931, as I understand from your testimony, this was the first year in which your company had any reason to consider any of its accounts and notes receivable, bills receivable and what have you, as possibly being uncollectible?

A. To the best of my recollection. That is a long time ago, and my memory is not any too long.

Q. Then in 1931, you have testified that in that year your accountant charged to a reserve for loss \$25,000 of the face amount of the Waterhouse note?

A. That is not entirely correct. He charged direct to profit and loss but the intent was that they should be—he had us instructed to charge it to a reserve for bad debt but didn't truly do it. We treated it as a reserve in the tax books but on the reserve it is charged to profit and loss.

Q. So that then for accounting purposes you adopted the actual method of charging off bad debts rather than the reserve method? [330]

A. Well, we, as I testified before, we never had occasion to use any reserves at all. We never had any reserve for bad debts on our books as long as I have been with the firm.

Q. What were the circumstances that motivated your company in charging off in the year 1931 only 50 percent of the face amount of the Waterhouse note?

A. Well, sir, to the best of my recollection the

(Testimony of Carl R. Linden.)

excuse given by the treasurer was, we had a good year and he wanted to be conservative.

Q. I notice also on the return for the taxable year 1931 of Alexander and Baldwin, under schedule "L" thereof is shown an item of \$17,500 as a reserve for taxes.

A. Yes. That is probably capital stock taxes. We can tell better on here.

Q. Well, I am not curious about what it is. Also up here under the charges against reserve for contingencies, and so forth, there is shown an item of \$9,762.58.

A. Correct.

Q. Charged off to a reserve for Territorial income tax paid from the reserve.

A. These reserves for taxes were set up primarily for purposes of showing the amount of money or earnings available for dividends. We actually took in the return the taxes that we paid during the year. These reserves did not enter into [331] our income for tax calculations.

Q. All right. Now, you testified that the accounts of Alexander and Baldwin, Limited, for the taxable years, for the calendar years 1931 and 1932, and I believe for all prior years, are kept on the cash receipts and disbursements basis?

A. Yes.

Q. Now, I would ask you to examine the balance sheets for the calendar year 1931, annexed to the corporations Federal income tax return for that year, and explain to the Court, then, if the accounts or the method of accounting as the cash basis of

(Testimony of Carl R. Linden.)

accounting, why they are shown on the balance sheets as reserve?

A. They are shown there reserved for depreciation.

Q. For taxation?

A. That's right, taxes. And that is a misnomer. That is not—you can't reserve a fund.

Q. And the reserve for employees benefit fund, the \$135,910.08, as of December 31, 1930, and the balance sheet shows as of December 31, 1931 the amount of \$141,125.23 carried in a reserve for employees benefit fund. Now, if the corporation is on a cash basis, will you explain to the Court please why that is carried as a liability?

A. If you will look on the assets side you will find an identical figure there. Those are just offsetting items, [332] practically so. The purpose of the employees benefit fund which was created a good many years ago was to provide a fund out of which doctors' bills and other charges like that of employees who were not able to carry them would be paid; and also to advance money to employees who wanted to buy their own homes. And so way back before my time some money, some hundred odd thousand dollars were appropriated and set aside which the management was permitted to loan to employees and utilized for purposes of paying medical expenses of themselves and families. That is the low-bracket employees. I don't get it.

Q. Now, will you read in to the record what the

(Testimony of Carl R. Linden.)

balance sheet as of December 30, 1931, shows on the asset side as the amount in the employees benefit fund?

A. There are \$134,840.22, and on the other side—

Q. What does the liability side show?

A. The liability side shows \$135,910.08.

Q. Now, as of December 31, 1931, will you please—

Mr. Pratt: If your Honor please, may I at this stage of the questioning object to further examination? Counsel has stipulated that the company is on a cash basis. I don't know what the purpose of this examination is.

The Court: Well, I don't either, and therefore I don't feel disposed to rule on it now, on the examination. Is there much more of this? [333]

Mr. Atherton: Well, I was trying to develop if they are on the cash basis, your Honor. Then why did they charge this? Why they carried this reserve here, your Honor?

The Court: Well, you are trying to find out whether they were really on a cash basis all the way through or just at convenience?

Mr. Atherton: That's right.

The Court: All right, go ahead.

A. I have never heard of any objection to having reserve in case where books are kept on the cash basis, and I have been an accountant for over 40 years.

Q. Would you say, then, Mr. Linden, that the

(Testimony of Carl R. Linden.)

method of accounting of this corporation was more of a hybrid method—— A. No, sir.

Q. ——than strictly cash method?

A. No, we are strictly on the cash basis.

Q. As to the contribution made of a thousand dollars to the Hawaiian Bureau of Research, did the taxpayer receive any direct benefit from that contribution?

A. If you mean by direct benefit that we can show in dollars and cents, how much we received, that would be no more possible to do that than it would to tell how much benefit you get by going to a dentist and having a tooth filled. But if we hadn't received benefits from it, we wouldn't have paid it in the first place. It was a very efficient organization, [334] that in every problem of Territorial administration there was and locally, and gave us periodical reports, and at least they claimed that they were instrumental in reducing unessential expenditures and conversely taxes by their activity.

Q. You testified, Mr. Linden, that you made this contribution a sort of duty-bound to your clients or those companies that you represented?

A. That's right.

Q. Do you know whether or not they likewise made contributions to this fund?

A. I am not prepared to answer that because I have not had occasion to look it up.

Q. Do you know whether or not any of them

(Testimony of Carl R. Linden.)

received direct benefits as a result of the activity of the Bureau?

A. We did it for their benefit. Our contributions were for the benefit of our clients so far as we ourselves are concerned. Our taxes, you might say, are nominal.

Mr. Atherton: Very well. Thank you.

(Witness excused.)

The Court: We will take a recess now until 1:45.

(The Court recessed at 12:20 p.m.) [335]

Afternoon Session

The Clerk: Civil No. 419, American Factors, Limited, versus Fred H. Kanne, for further trial.

The Court: You may proceed.

Mr. Wild: I would like to have Exhibit P-13, if I may have it. I'd like to call your Honor's attention and read Plaintiff's Exhibit P-13, except for the details according to the schedules. It is headed as Bank Examiner's Report of the condition of Henry Waterhouse Trust Company, Limited, Honolulu, T. H., at the close of business December 31, 1932. And then an official cover of the Territory of Hawaii.

"Bank Examiner's Report of the Condition of Henry Waterhouse Trust Company, Limited, Honolulu, T. H., at the close of business December 31, 1932.

“A copy of this report of examination is furnished to the Board of Directors of the examined institution for their information and consideration. The information contained herein is based upon the records and books of the institution and upon statements made to the Examiner by officers and employees, and on data secured from other sources believed to be reliable, and presumed by the Examiner to be correct.

“Much of the information in regard to the assets of the institution is of such a character as to make it necessary for the Examiner to rely upon the good faith and assurances of his informants, and while the Examiner regards the statements [336] so accepted by him as correct, he is, necessarily, not in a position to guarantee the accuracy of such part of the information as may not have been obtained at first hand.”

That is the usual printed form, your Honor. Then it names the officers and directors, which I will omit.

“To the Stockholders and Directors,
Henry Waterhouse Trust Company, Limited,
Honolulu, T. H.
Gentlemen:

“We have completed an examination of the condition and affairs of the Henry Waterhouse Trust Company, Limited, as at December 31, 1932, and common thereon as under.

“Various analysis and schedules in the form of exhibits have been prepared from the records and

books of the company to present its financial position as at December 31, 1932. Much of the information in regard to the assets of the company is of such character as to make it necessary for the Examiner to rely upon the good faith and assurances of his informants, and while the Examiner regards the statements so accepted by him as correct, he is, necessarily, not in a position to guarantee the accuracy of such part of the information as may not have been obtained at first hand.

“The records of the Henry Waterhouse Trust Company, Limited, show that subsequent to February 14, 1931, and [337] shortly after the company was taken over by the Bishop Trust Company, Limited, sufficient assets appeared to be on hand to meet all liabilities of the company. See Auditor’s Report of February 14, 1931. An analysis of the various asset and liability accounts of the company made by us as at December 31, 1932, disclosed, according to our figures, an insufficient amount of assets to meet the remaining liabilities. We have prepared and submit herewith Exhibit ‘B’ of the analysis made.”

Would it be helpful to your Honor to follow a copy of this? I have a copy.

The Court: As to the figures?

Mr. Wild: Yes.

The Court: Yes, you may pass me a copy.

Mr. Wild: I am reading now from the third paragraph. “We have prepared and submit herewith Exhibit ‘B’ of the analysis made. Contingent

reserve and capital are entirely absorbed and Bishop Trust Company, Limited, advances to an amount of \$255,215.61 were used to meet estimated losses."

The Court: Which sheet is this?

Mr. Wild: You mean what I am reading? It is from the third paragraph, your Honor, in the letter.

The Court: Yes. I wasn't so much interested in that.

Mr. Wild: Oh, it is the sheet "B" as annexed.

The Court: Page four? [338]

Mr. Wild: I think it is this one. Isn't that sheet "B"?

The Court: Page five. Oh, yes, that's right.

Mr. Wild: "Contingent reserve and capital are entirely absorbed and Bishop Trust Company, Limited, advances to an amount of \$255,215.61 were used to meet estimated losses.

"The policy of the Bishop Trust Company, Limited, in the future with respect to the application of assets to pay liabilities should be to assign cash, real estate mortgage loans and participation in large real estate mortgage loans to respective individual fiduciary, trust and deposits credit balances. Large real estate mortgage loans suitable for trust investments should be reappraised, renewed and arranged to permit the issue of participation certificates thereon. As the payments on account of loans assigned are received the respective fiduciary, trust or deposit accounts should receive the benefit thereof. Pursuit of this policy should, in time, liquidate all individual fiduciary, trust and deposit liability accounts.

“The cash thus accumulated should be deposited in a special bank account and not kept with or made a part of the general funds of the Henry Waterhouse Trust Company, Limited, or its affiliates.

“The Henry Waterhouse Trust Company, Limited, because of its insolvent condition, cannot carry on a business. Whatever business is required to be transacted should be done [339] by the Bishop Trust Company, Limited.

“Every effort should be made by the Bishop Trust Company, Limited, to maintain this policy. Unusual demands for cash withdrawals by clients, the payment of which cannot be avoided, should be met from general funds on hand or from funds advanced by the Bishop Trust Company, Limited, but not from the accumulated funds of other clients.

“Assets in the form of stocks, bonds, loans, advances, receivables, real estate owned and other of doubtful value or that cannot readily be applied to a liability or liabilities should be assumed by the Bishop Trust Company, Limited, who assumed the ultimate liability, if any, of the Henry Waterhouse Trust Company, Limited, as stated in letter of March 14, 1931, of the Bishop Trust Company, Limited, to Hon. E. S. Smith, Treasurer of the Territory of Hawaii, and as set forth in paragraph 4 of letter dated February 24, 1931, sent to each of the contributors for the \$400,000.00 Special Reserve which reads: ‘The Bishop Trust Company, Limited, will ultimately contribute such amount, if any, over the above sum of \$1,035,000.00 as may

be required to liquidate the liabilities of the Henry Waterhouse Trust Company, Limited.'

"You are requested to fully analyze all investments held in your trust and estates portfolios to determine the soundness of such investments and their qualification for trust and [340] estate investments. Any investment found unqualified or that there is a possibility that they will not be accepted by the courts you will remove and replace with other qualified investments.

"You are also requested to follow the procedure for the future conduct of the affairs of the Henry Waterhouse Trust Company, Limited, outlined above.

"Losses should be written off as they occur or as they become evident; we refer particularly to the J. P. Looney real estate mortgage loan and the old trust and agency debit balance accounts now on the books which were eliminated when the properties of J. P. Looney were acquired thru foreclosure sale, and the old fire and old life insurance premium accounts deemed uncollectable.

"Attached hereto and made a part of the comments are the following exhibits and schedules applicable as at December 31, 1932."

Then as Exhibit "A" the balance sheet; Exhibit "B," analysis of assets and liabilities; Exhibit "C," analysis of real estate mortgage, collateral and unsecured loans. Then there is Schedule 1, stocks and bonds pledged as security for loan from Bishop First National Bank of Honolulu, and the other

schedules which I don't care to read because they are the detailed schedules of which the first is the summary.

Then Exhibit "A" shows—well, it says, "Examiner's [341] Report of Condition of the Henry Waterhouse Trust Company, Limited, Examination commenced at 1:00 p.m., January 11, 1933, and 8:00 a.m., March 4, 1933; closed at 4:00 p.m., January 29, 1933, and closed at 4:00 p.m., May 16, 1933. Made by Geo. Theurer, Examiner-in-Charge, and Assistant T. A. Lyons."

Exhibit "A" shows resources: Cash on hand and in banks, \$14,639.50; stocks and bonds, \$267,122.42; stock of affiliated companies, P. E. R. Strauch, Ltd., \$293,704.16, Kaimuki Land Co. \$10,000.00. The total, \$303,704.16. Advances to affiliated companies, P. E. R. Strauch, Ltd. \$114,000.00, Kaimuki Land Co., Ltd. \$40,787.92, which makes a total of \$154,787.92. Receivables: Life insurance accounts, \$9,530.80, life insurance notes \$5,683.89, T & A general accounts \$42,798.86, and T & A petty accounts \$256,766.46, or a total of \$314,780.01. Loans: real estate mortgages, \$839,524.74; collateral, \$934,563.61; unsecured, \$10,651.77. The total, \$1,784,740.12. Real estate owned: Pacific Heights, \$20,000.00; Horner property, \$149,700.00; Looney property, \$63,573.02. The total, \$235,273.02. Other assets: stock exchange seat, \$10,000.00; furniture and fixtures, \$6,119.16; automobiles, \$1,207.50. Total, \$17,326.66. Real estate held in trust, \$92,500.00. Offset by note to Bank of Hawaii, \$92,500.00. Sus-

pense: operating and management, \$17,500.00. Total, \$3,107,873.81. [342]

Liabilities: Brokers: Russel Miller & Co., \$23,-601.77; Goodbody & Co., \$21,580.93; total \$45,182.70. Notes payable, \$674,190.88. Bishop Trust Company advances, \$585,000.00. Trust and Agency accounts: general accounts, \$685,245.04; depositors accounts, \$383,662.24; total, \$1,068,907.28. Pledged to clients: real estate loans, \$132,128.00. Merchandise account, \$1,458.44. Suspense account: Bishop Trust Co. \$17,500.00; Mizushima Commission, \$2,417.13; tax on drafts and checks, \$6.96. Total, \$19,924.09.

The Court: Total what?

Mr. Wild: The total of these suspense account items.

The Court: How much?

Mr. Wild: \$19,924.09.

The Court: Yes.

Mr. Wild: Then the total of all above is \$2,526,-791.39. Then contingent reserve: for losses, \$271,-294.27; underwriters, \$400,000.00. Total of those items, \$671,294.27. Loss of \$490,211.85. Balance, \$181,082.42. Capital stock, \$400,000. The total of the liability figure is \$3,107,873.81.

Now, in Exhibit "B", analysis of assets and liabilities as of December 31, 1932. The assets show the summary and at the bottom in the lower right-hand corner I call Your Honor's attention to "No Value", Donations Capital \$400,000.00 Nil, Contingent Reserves \$181,082.42 Nil. And it shows a deficit of \$255,215.61. [343]

The Court: That is after the donations are written off?

Mr. Wild: Yes, Your Honor. In other words, this statement, Exhibit "B", shows that after the \$400,000 donations are out of the picture, Bishop Trust Company, Limited, will sustain losses of \$255,215.61 on account of its guarantee.

The Court: These were pretty drastic revaluations, weren't they?

Mr. Wild: Yes, Your Honor.

The Court: Well, they were almost of a panicky nature, weren't they?

Mr. Wild: No, you wouldn't have seen anything yet, because it goes on with a pile-up of other losses. We were really going into the turmoil of the depression, as Mr. Castle testified this morning. This is an independent examination by the bank examiner's office, from all sources.

The Court: Were these book assets prior to this revaluation—they had already been revalued and sustained quite a very substantial depreciative value, didn't they?

Mr. Wild: Yes, Your Honor. But as Your Honor will remember, that was the day when assets in '32, asset values were dropping. I think Radio Corporation stock would go down from fantastic amounts to a very few dollars. And that is what happened here. This bank examiner's report shows the plunge that was made in values, Hawaii following the mainland.

The Court: Was there such a drop in bond val-

ues from [344] fifty-seven thousand odd dollars down to fifteen odd thousand dollars?

Mr. Wild: Well, Your Honor, the bond values——

The Court: About 70 odd percent depreciation in bond values?

Mr. Wild: Yes. Schedule 2, stocks and bonds—— which item is it there that you are reading from?

The Court: I am reading from the stocks and bonds in this Exhibit "B". I was looking at the estimated loss requiring reserves, fifteen thousand dollars loss.

Mr. Wild: The schedule which isn't there shows the items of those. It shows these different valuations made at market. It shows each item in that valuation, and how many shares or how many bonds there were, what the book value was, and what the then market value was. Those have gone into exhaustive detail, Your Honor, showing the picture as these gentlemen saw it at this time, and they were an independent value.

The Court: Well, they weren't actually put on the market and sold at those values, were they?

Mr. Wild: No, unfortunately.

The Court: Unfortunately?

Mr. Wild: Yes, because they were sold at even a lesser value, many of them, later.

The Court: Yes. All right. [345]

Mr. Wild: Each year thereafter, if we want to go into it, would show an increasing——

The Court: I have no occasion to go in and criticize figures of that sort.

Mr. Atherton: Your Honor, can I ask a question? Has this exhibit been admitted in evidence?

Mr. Wild: Oh, yes, P-13.

Mr. Atherton: Was it admitted?

The Court: Yes, I understand it was admitted.

Mr. Atherton: The whole report was admitted?

The Court: The whole report. Your objection was to the admission of a portion of the report without putting all of it.

Mr. Atherton: I guess it is too late for me now to hand an objection to the full report. I would like to——

Mr. Wild: Well, he planned the whole report.

Mr. Atherton: What I recollect was that I said if any part, the whole report should go in, but I don't know whether the record will show that I objected, that I raised no objection—if it is not too late now I would like to object to the admission in evidence of the whole report or any part thereof on the ground it is immaterial and irrelevant.

The Court: Immaterial and irrelevant?

Mr. Atherton: I will tell you why. Because the report as made on the face of it purports to have been an examination [346] conducted during the year 1933. And the report was dated July 20, 1933.

The Court: Well, you should have pointed that out to the Court at the time the matter was under discussion earlier. I got the impression that the only objection you had to it, to the offer, was to

excerpts of the report, and that if anything in connection with the report was to be offered that you wanted the whole report in. That was the impression I got.

Mr. Atherton: Yes, that was the way I felt about it. I don't know that I made myself clear, and I know I should have made myself more clear. The whole thing took me by surprise.

The Court: I don't feel disposed now, after all this time, to strike it from the record. But the Court will keep in mind that this report was made in '33 after the former transactions of writing off the bad debit.

Mr. Wild: The other supporting schedules which I won't call attention to here are along the same lines, Your Honor. It shows how they have written down the various ones. And the report, I might state, although actually made after the year, was made for the calendar year 1932. Those dates went in this morning, Your Honor. And it shows in the first page of the report itself that immediately after the end of the year '32 the bank examiner's office started work, and they [347] couldn't very well until they had the '32 accounts in, Your Honor. We have no further evidence at this time. I haven't read a number of our exhibits in toto, but I take it that our failure to read them in toto doesn't mean that we can't refer to them in arguments or briefs.

The Court: All right.

Mr. Pratt: We have no other evidence, Your Honor.

The Court: Both parties plaintiff close?

Mr. Atherton: Now, for the Government, Your Honor, I'd like to offer in evidence—I'd like to mark it for identification in the Alexander and Baldwin case, as the Government's exhibit, Defendant's Exhibit No. 1, a certified photostatic copy of the Federal income tax return of Alexander and Baldwin, Limited, for the calendar year 1932.

The Court: Tax return for the year 1932? We have no exhibit 1 as yet?

The Clerk: No.

The Court: We will call that Exhibit 1.

Mr. Wild: Might that be marked Defendant's 1, that is, in the A. and B. case?

Mr. Atherton: No objection.

Mr. Pratt: No objection.

Mr. Atherton: Then I offer it in evidence as Defendant's Exhibit 1 in the Alexander and Baldwin case.

(The document referred to was received in evidence as [348] Defendant's Exhibit 1 in the Alexander & Baldwin case.)

Mr. Atherton: Then I'd like to have marked for identification a certified photostatic copy of the Commissioner's 90-day deficiency letter dated June 2, 1936, addressed to Alexander and Baldwin, Limited, with respect to the tax year 1932. I'd like that to be identified as Defendant's Exhibit No. 2 in the A. and B. case.

Mr. Pratt: No objection.

Mr. Atherton: There being no objection interposed, I offer that in evidence as Defendant's Exhibit 2.

The Court: I understand now both of these documents are accepted in evidence, and not merely for identification.

(The document referred to was received in evidence as Defendant's Exhibit 2 in the Alexander & Baldwin case.)

Mr. Atherton: Then I'd like to identify—well, I will offer in evidence as Defendant's No. 3, a certified copy of the claim for refund filed by Alexander and Baldwin, Limited, for \$8,853.06, Federal income tax alleged to have been overpaid for the calendar year 1932.

The Court: What is the date?

Mr. Atherton: The amount is \$8,853.06.

The Court: I say, the date?

Mr. Atherton: Oh, the date of the claim? The date shown on here appears to be December 15, 1936, that it was filed.

(The document referred to was received in evidence as Defendant's Exhibit No. 3 in the Alexander & Baldwin case.) [349]

The Court: Yes. All right.

Mr. Atherton: No, I am sorry, it is earlier than that. November 27, 1936, Your Honor. It is a mistake.

Mr. Cades: Shouldn't that be lettered A, B and C instead of numbers?

Mr. Pratt: They are in the other case, Your Honor. Our case number is 474. And I think if it is in that case, it wouldn't be mixed up with this.

The Court: Well, I've got this all under the matter of A and B's case.

Mr. Wild: Mr. Cades was referring to this, Your Honor. I thought in our case that if we numbered the plaintiff's exhibits and called them "P" and by number, then the Government's A, B, C and D. We could differentiate easily between the exhibits adduced on testimony and those attached to stipulations.

The Court: We can do that very well when we get to it. Now we are taking these A and B's as 1, 2 and 3. We will take yours as A, B and C.

Mr. Wild: Yes.

Mr. Atherton: I would like to offer in evidence a certified photostatic copy of Deputy Commissioner's letter dated November 14, 1940, notifying Alexander and Baldwin, Limited, of the objection in its entirety of its claim for refund of \$2,941.90 and \$8,853.06 Federal income taxes for [351] the years 1931 and 1932, respectively.

The Court: Received in evidence. Both bound together, are they?

Mr. Atherton: There is only one letter.

The Court: As Exhibit 4.

(The document referred to was received in evidence as Defendant's Exhibit No. 4 in the Alexander & Baldwin case.)

The Court: What is the date of that letter?

The Clerk: November 14, 1930.

Mr. Atherton: Forty.

The Clerk: Forty, is it? I can't read it.

Mr. Atherton: That concludes the Government's evidence in the Alexander and Baldwin case, Your Honor.

The Court: Yes.

Mr. Atherton: Now, with respect to the case of the American Factors, Limited, the Defendant would like to offer in evidence the Commissioner's 90-day deficiency letter dated September 3, 1937, addressed to the American Factors, Limited.

The Court: Thirty-seven, December 3, 1937?

Mr. Atherton: Yes, Your Honor.

Mr. Wild: September, wasn't it?

Mr. Atherton: September 3, 1937, addressed to American Factors, Limited, wherein the Commissioner made an original determination of a deficiency for the calendar year ended December 31, 1932, of \$62,438.82. [351]

The Court: Sixty-two thousand?

Mr. Atherton: Four hundred thirty-eight dollars and eighty-two cents, in income tax for that year. Any objection?

Mr. Wild: Yes, Your Honor. I will object to that as incompetent, irrelevant and immaterial. We have answered that deficiency letter in our claim for refund and it hasn't been denied. And there is also other evidence in the case, and the statement can only be used there in the event there isn't any other evidence. That is just my objection.

The Court: Let me get that now. The objection to this letter is that you have answered it in——

Mr. Wild: I have answered the allegations of fact made in that letter, and the law, in my claim for refund. And my claim for refund has not been denied. It was annexed to the complaint. And that therefore this letter can be of no probative value, for any of the facts therein stated.

The Court: Well, for nothing more perhaps than calling the Court's attention to it.

Mr. Wild: Very well.

Mr. Atherton: No, Your Honor, this letter represents an official determination by the Commissioner of Internal Revenue of a deficiency for the taxable year 1932. And when the Commissioner makes a determination of a deficiency the burden is upon the taxpayer to overcome that determination, to show that it is in error. The Commissioner's determination is [352] *prima facie* correct. Now, we will show at the proper time, unless you wish to do it now, that the Government's answer, the Defendant's answer to the complaint in this particular case did deny in effect or did not—no, that the allegations in the complaint with respect to the claim for refund did not require any responsive pleading in that they merely allege that a claim for refund, a copy of which was annexed to the complaint, was filed giving the date of filing. Now, under those circumstances the Defendant's contention is that that type of an allegation required no responsive pleading because there was no issue of

the fact of the claim for refund that was filed. There was no intention, nothing in the allegations that incorporated by reference the so-called allegations of fact made in the claim for refund that would require responsive pleading by the Defendant to that allegation.

And for the Court's information, let's turn to the complaint. Paragraph 23 of the complaint states:

"That on or about April 5, 1938, Plaintiff filed with the Commissioner of Internal Revenue through the Collector of Internal Revenue, his agent for that purpose, a claim for refund (a copy of which is attached hereto and marked Exhibit 'A') covering the calendar year 1932 on Form 843, as prescribed by the Commissioner of Internal Revenue, for the refund of said \$80,254.41, which claim was rejected by the Commissioner [353] on or about December 2, 1938."

Now, as I understand the Plaintiff's contention, that because in the answer the Defendant failed to either admit or deny that allegation that thereby it was tantamount to an admission of all the allegations of fact contained in the claim for refund. And I think that is a preposterous proposal to make to this Court. It is absolutely ridiculous. And when you come to paragraph 26 of the complaint, it reads this way:

"That on or about December 22, 1938, Plaintiff filed with the Commissioner of Internal Revenue through the Collector of Internal Revenue, his agent for that purpose, a claim for refund (a copy of

which is attached hereto and marked Exhibit 'B') on form 843, as prescribed by the Commissioner of Internal Revenue, for the additional amount of \$16,880.49 so paid by Plaintiff to Defendant on October 26, 1938; that more than six months have elapsed since the filing of said claim and the Commissioner has neither accepted nor rejected the same."

Now, certainly, Your Honor, this failure to specifically deny or admit that allegation doesn't admit the allegations of fact set forth in detail in the claim for refund. There is no substance to the Plaintiff's——

The Court: Do you want to be heard on that?

Mr. Wild: Oh, yes, Your Honor. In legal proceedings [354] rules applicable to pleadings are binding alike upon the Court and counsel, as I apprehend it. The United States had just adopted the Rules of Civil Procedure for its District Courts, and in those rules they prescribed the forms of pleadings and what the reference to a written instrument meant. And in 10(c) of those rules it states in part as follows: "Adoption by Reference; Exhibits. A copy of any written instrument which is an exhibit . . ." And this is an exhibit to a pleading. " . . . which is an exhibit to a pleading is a part thereof for all purposes."

In other words, when I just annex that, that this is a true copy, that makes that written instrument by virtue of the law a part of that pleading for all purposes, meaning that every allegation that is in

there is an allegation of fact which requires either responsive answer or, if you don't file a responsive answer to it, you admit it.

Now, that precise point has been up before the Court, Your Honor. In the case of Peoples Natural Gas Company versus Federal Power Commission, 1942, 127 Federal 2nd 153, the Federal Power Commission made a motion to compel the Gas Company to allow the Commission access to the company's books and records. The motion filed by the Commission in the District Court did not allege any facts showing the Commission had jurisdiction to demand the books and records. In an exhibit attached to the motion, just like our exhibit [355] is attached to the complaint, the Commission stated that the Company sold gas at its station in Pennsylvania to an affiliated company in New York. The answer of the company filed denied that it is a natural gas company within the meaning of the Act, and stated that,

" . . . it did not transport natural gas in interstate commerce or sell natural gas in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use."

The Court of Appeals held these denials were in the nature of legal conclusions and were not denials of the statements of fact set out in the exhibit. Consequently, the company was deemed to have admitted the facts alleged in the exhibit under Rule 8(b). So that, Your Honor, when we set forth an

exhibit annexed to either a complaint, answer or motion, all statements in that exhibit are in the pleadings for all purposes by virtue of our new Federal rules. I say "new." They have been in effect, what is it, seven, eight, nine years now? And in consequence they call for a responsive pleading. If there is no responsive pleading, then under the provisions of 8(d), "Effect of Failure to Deny," it requires a responsive answer, being facts stated in a part of the pleading, and they are admitted for failure to deny.

So that, Your Honor, to save my point, I renew my objection to these letters going in on the ground that the [356] claim for refund sets forth facts in answer to the Commissioner's position which facts haven't been denied. I will admit, Your Honor, that solely and simply for the purpose of determining what items of income were passed on by the Commissioner, solely for the tabulation; if the offer were confined to that it would be proper. But as I understand it, the offer made is for all purposes. I have no objection to it going in just merely to show the tabulations, Your Honor.

Mr. Atherton: The offer is made for all purposes. It is made to lay the foundation that the taxpayer had not overcome the prima facie determination of the Commissioner. If the taxpayer is honest in his present position, Your Honor, it seems to me that he is rather untimely now. He should have moved for a judgment on the pleading at some other earlier stage of this proceeding. He has of-

ferred evidence here. He has practically admitted that there was a general denial on the part of the Government to his complaint. Otherwise he has taken up this Court's time, my time, and everybody else's time unnecessarily. Now he is seeking relief on a hypothetical issue.

The Court: Well, you said something about when this matter first came up that it was your intention, as I gathered it, to amend your answer to conform with the evidence.

Mr. Atherton: Yes, Your Honor, that is what I intended to do, at the close of the Government's proof in this case to [357] move then that the pleadings be amended to conform to the proof in the evidence.

Mr. Wild: Might I suggest, Your Honor, if counsel can do that now, what good are those rules? We might just as well tear up 8(c) and 10(d). They are of no effect. I had to go forward on certain evidence, on certain matters that are denied. Therefore, I didn't file a motion for judgment on the pleadings. I certainly don't enjoy any counsel, especially a strange counsel, impugning my honesty of motive, why I wasn't honest with the Court. I certainly was honest with the Court. I put on the evidence what I think answers completely everything that was denied. And I think on the basis of that we should claim judgment.

Mr. Atherton: Your Honor, it is within your discretion to determine whether or not these allegations in the complaint, to which he says there has

been admission, required a responsive pleading, in the sense that he believes such a responsive pleading should be made.

The Court: Well, I wouldn't think so. That case cited is a little distressing, if I got all of it, however. It would seem to me that the failure to deny is simply an admission that such a document exists and was placed before the Court in the Plaintiff's pleading.

Mr. Wild: Well, then, what does Your Honor do with 10(c)? Do you brush that aside and say it is meaningless, [358] when you annex an exhibit to a complaint, not technically, Your Honor? When I followed these rules down—and this isn't the first case that I ever pleaded under the rules—I came to the conclusion that whatever exhibit I had was an allegation, and it certainly was under 10(c). And all authorities that I looked at, being scarce then, the general authority and the notes, led me to believe that that is true.

The Court: I wouldn't have thought that that rule meant that.

Mr. Wild: Well, what does it mean?

The Court: Look what a field for slipshod, dangerous, treacherous pleadings it would open up.

Mr. Wild: Well, doesn't it all? There is the exhibit, and we all know that it is an averment of fact. And anybody, and especially Government counsel, should know their rules of pleading. And there isn't any ground for being slipshod there, Your Honor, I wouldn't think. I knew at the time

I prepared my complaint that when I annexed a written instrument as an exhibit that it was in for all purposes. And I plead it that way on purpose under that rule, Your Honor. And I don't see where there is any trick or any slipshodness about it. The whole thing is, Your Honor, that it calls upon the Defendant or the Plaintiff, as the case may be, if the instrument is in the Defendant's answer it calls upon them to deny the truth of any allegation of fact that is made in [359] that exhibit. And if they don't care to do that, that is all right.

Now, I had to put on some other evidence, naturally, because there are one or two things here that we denied. And I put on the other evidence now. And then I claim that this 90-day letter can't be adduced in evidence to overcome or show anything.

The Court: Well, upon the Defendant's assertion that it is the intention to move to amend the Defendant's pleading in answer, the objection is overruled.

Mr. Wild: May we have an exception, Your Honor? May we have one ground there that wasn't stated, because Your Honor ruled that it was upon his assertion that he was going to move to amend that that it was allowed? On the further ground I want to make my objection and exception, that any such procedure destroys the efficacy of our rules of pleading, because it permits a party to avoid, and if there is to be any avoidance it should have come at an early date instead of waiting eight years after. In other words, their motion to amend is far too late, Your Honor.

The Court: Well, as I understand it, a motion to amend can be made any time before judgment.

Mr. Wild: But it could only be made to conform to the proof. You can't pull yourself up by your bootstraps. You can't put in your proof first and then say, Your Honor, I [360] want to amend it, I want to amend it to conform to the proof. The proof has to go in first. Now, his motion to amend has got to be based upon the proof being in the record. And here the only way he'd get that evidence in the record upon which he bases his motion to amend is by putting it in after the motion to amend could be granted, you see, and as it isn't in evidence at that time there is no ground laid for amending the pleading.

And these rules of court, Your Honor, they are not traps to trap the unwary. Government counsel have volumes—I had reference to them—of how they should plead these things. I have one myself. Your Honor has one. I submit, Your Honor, that Government counsel when he went over there at that time, when they went off there they couldn't deny allegations of fact in that and that they therefore refused to put in a denial. I don't know what motivated them. I am quite certain that nobody got caught off third base by not knowing that an exhibit required a responsive pleading, because all you had to do is pull the book down and read it. And it says in there that it is in for all purposes. The mere fact that this counsel comes out here eight years late to try this case, while we were

dickering before on settlement, gets a different theory on the case than the Government and counsel who filed the answer, doesn't afford any basis for a change, Your Honor. [361]

Mr. Atherton: Your Honor, I have no different theory than the man who filed the answer.

The Court: All right. Unless you want to clear up something, we will go ahead.

Mr. Atherton: Mr. Wild, you asked that these exhibits be numbered in your case?

Mr. Wild: Well, I would assume it would be Defendant's Exhibit A.

Mr. Atherton: Defendant's Exhibit A.

Mr. Wild: And may we have our exception to the ruling?

The Court: Yes.

The Clerk: Defendant's Exhibit A.

(The document referred to was received in evidence as Defendant's Exhibit A.)

Mr. Atherton: Defendant also offers in evidence a photostatic copy of a true copy of a Commissioner's second deficiency 90-day letter dated June 29, 1938, addressed to American Factors, Limited, wherein he made a determination of a deficiency of \$12,657.68 in income tax for the taxable year ended December 31, 1932.

Mr. Wild: May we have the same objection, Your Honor?

The Court: Yes.

Mr. Wild: And the same exception?

Mr. Atherton: That may be marked as Defendant's Exhibit B. [362]

(The document referred to was received in evidence as Defendant's Exhibit B.)

Mr. Wild: I understand, counsel, that those are photostatic copies.

Mr. Atherton: True photostatic copies of the original letter. I have the original carbons in my file, if there is any question about it. May I inquire, is the corporation's 1932 income tax return in evidence?

Mr. Wild: I believe I called on counsel to provide it. I believe it is our P-1. No, it isn't either. No, it is P-6. Our photostatic copy of our income tax return for the calendar year 1932 is Exhibit P-6, Your Honor.

Mr. Atherton: I don't believe, Your Honor, that the Government has any other documentary evidence or otherwise to offer in this case.

Mr. Wild: Do you have the letter rejecting——

Mr. Atherton: I will offer the claims, if you want that. I will offer the claims for refund, if I may be permitted, then. I will offer in evidence as Defendant's Exhibit——

The Court: That would be C if it is accepted.

Mr. Atherton: I am just trying to identify them. Defendant's Exhibit C, a certified photostatic copy of the claim for refund filed by American Factors, Limited, with the Collector of Internal Revenue at Honolulu on April 5, 1938, for the claiming of refund of \$80,254.41. [363]

The Court: \$80,254.41?

Mr. Atherton: Federal income tax and interest for the calendar year ended December 31, 1932.

Mr. Wild: That is a true copy of it.

The Court: December 31st?

Mr. Atherton: 1932.

The Court: Oh, yes.

Mr. Atherton: That is a claim for refund.

The Court: Of \$80,254.41 tax from this date that it was presumably paid?

Mr. Atherton: Yes, it is a claim for refund of the tax they paid for the year 1932.

The Court: With the interest to run from when?

Mr. Atherton: Interest? Well, it doesn't say when the interest is to run. It merely states that the date of payment was December 30, 1937, so I assume that the interest to run from that date, your Honor. Let me see if I have——

Mr. Wild: Yes, the interest would run from the date of payment, your Honor.

The Court: Yes.

Mr. Wild: And the date of payment is shown here as December 30, 1937. Do you offer that in evidence for all purposes?

Mr. Atherton: For all purposes.

Mr. Wild: We have no objection. [364]

The Court: Received as Exhibit C.

Mr. Atherton: I am not offering this as evidence of the truth of the statement, the allegations made therein. I am offering it in evidence as a true copy

of refund filed. That is the limited purpose of the offer.

(The document referred to was received in evidence as Defendant's Exhibit C.)

Mr. Atherton: Now I wish to offer as Defendant's Exhibit D a true photostatic copy of a letter dated December 2, 1938, addressed to American Factors, Limited, by the Deputy Commissioner of Internal Revenue, notifying the taxpayer of the rejection of its claim for refund of \$80,254.41.

Mr. Wild: What is the date again?

Mr. Atherton: Income tax for the year 1932.

The Court: Rejection of how much?

Mr. Atherton: \$80,254.41.

The Court: That is the entire claim?

Mr. Atherton: That is the entire claim.

Mr. Wild: Is that December 2nd?

Mr. Atherton: Yes.

Mr. Wild: No objection.

The Court: Received as Exhibit D.

(The document referred to was received in evidence as Defendant's Exhibit D.)

Mr. Atherton: And I'd like to offer in evidence as [365] Defendant's Exhibit F——

The Court: Why miss E?

Mr. Atherton: This is E now?

The Court: Yes.

Mr. Atherton: Sorry. Defendant's Exhibit E, a true certified copy, photostatic copy of a second claim for refund filed by American Factors, Limited,

with the Collector of Internal Revenue at Honolulu on December 23, 1938, claiming the refund of \$16,880.49, of which \$12,657.68——

The Court: Twelve thousand what?

Mr. Atherton: ——\$12,657.68 represented income tax for the calendar year ended December 31, 1932, and interest in the amount of \$4,222.81.

The Court: Four thousand two hundred?

Mr. Atherton: \$4,222.81.

The Court: How much claim on the whole business?

Mr. Atherton: That represents, the sum of those two amounts is the amount claimed to be refunded in this second claim for refund.

The Court: Well, what? What they claim is an additional or second claim, is it? Is it an additional or second claim, when you say \$12,657.68 for 1932 taxes?

Mr. Wild: Same year, your Honor. The Commissioner changed his mind.

The Court: What is the \$16,880.49? Is that also——[366]

Mr. Wild: Yes, your Honor.

The Court: Is that also in 1932?

Mr. Wild: Yes, your Honor. In the Commissioner's letter he allowed a portion of the Hackfeld litigation expenses.

The Court: I came across that somewhere.

Mr. Wild: And he allowed that as a deduction. He allowed the payment made to the widows and orphans of deceased employees, and then he as-

sessed a tax on the basis of reversing his position, and he assessed an additional tax on that account.

The Court: Well, where is the documentary exhibit that shows what he had allowed in the first instance?

Mr. Atherton: That is in the first 90-day letter, your Honor, that was put in here.

The Court: Oh, yes.

Mr. Atherton: And in the second 90-day letter is where he made the subsequent adjustment.

The Court: Now, you've got stuff in there that I haven't seen. All I know is just that there was a letter referred to as a deficiency, 90-day deficiency letter. That doesn't mean anything to me.

Mr. Wild: Well, your Honor, in the pleadings here I have it all set out, and they have admitted it by failure to answer. In my paragraph 20, for instance, that in and by said letter the said Commissioner disallowed its deduction, all but \$87,992.50, of the Hackfeld litigation expenses; and [367] stated that of the amount paid by Plaintiff on account of the Hackfeld litigation expenses only the amount of \$87,992.50 accrued during the year 1932. That is, in other words, in the first deficiency letter he did claim to disallow all of the Hackfeld litigation expenses except those items that were paid and settled in the year 1932, as are shown on Exhibit P-7; and the summary which shows recap total expenses, 1932, \$87,992.50. Now, he allowed that in the first letter.

The Court: He allowed a deduction of 87—

Mr. Wild: That's right, in the first letter.

The Court: In the first letter? That is in this Exhibit A?

Mr. Wild: That's right.

Mr. Atherton: That's right. In the first 90-day letter.

Mr. Wild: And I show that in my pleading.

The Court: Is it a long letter? Could we know what that exhibit means?

Mr. Wild: Well, in technical income tax problems, your Honor, as you know, the Commissioner of Internal Revenue in Washington, when he finally reviews a case, gets out a final letter and it is called a 90-day letter. That 90-day letter permits the taxpayer to file an appeal to the Board of Tax Appeals within 90 days after the date, after the mailing date of the letter, or it permits him to pay the tax when it is assessed and file suit for refund. In that 90-day letter [368] the Commissioner states the summary of his findings.

The Court: That's what I want to know.

Mr. Wild: And that is the letter that I objected to because our claim for refund answers it, and it's been admitted. And I take it that my exceptions to the reading and consideration of the letter and all those matters pertaining to it are noted?

The Court: Naturally.

Mr. Atherton: Do you wish me to read it?

The Court: Yes.

Mr. Wild: But I have pled the result of it in the complaint.

Mr. Atherton: Well, all this comes as a great surprise to me. Therefore, I had to extemporaneously prepare myself. I wish to reserve the right for the Government in a supplemental brief to discuss this aspect of the situation and some others.

Well, now, looking at this Defendant's Exhibit A, on the statement attached to that 90-day letter, deficiency letter, your Honor, it shows this, it says, first, it sets forth the tax liability to be \$62,438.82. And it states that no amount of that tax has been assessed and therefore it concludes that that same amount represents the deficiency. Continuing with the letter, the statement in the deficiency letter reads as follows: [369]

"The deficiency shown herein is based upon the report prepared by Revenue Agent H. A. Peterson, a copy of which has been furnished you, and other data available to this office. The adjustments producing the deficiency are shown in schedules 1 and 2, and exhibit 'A', attached.

"Careful consideration has been accorded the statements set forth in your protests dated March 29, 1935 and May 28, 1937, and depreciation schedules filed with the internal revenue agent in charge, Honolulu, Territory of Hawaii, on December 5, 1936, and proper allowance made therefor in the determination of the deficiency shown above.

"The exceptions to the proposed adjustments to income reported on your return for 1932, as set forth in your protest dated May 28, 1937, are summarized as follows:

“1. Miscellaneous unallowable deductions \$5,-694.00.”

The Court: Is that under contest?

Mr. Wild: No.

Mr. Atherton: Not under dispute at all. No contest about that.

“2. Litigation expense \$480,615.26.”

That item is in dispute in this proceeding.

“3. Waterhouse Trust Co., Ltd. adjustment \$50,000.00.”

That item is in dispute in this proceeding.

“4. Depreciation \$889.84.”

Mr. Wild: No dispute on that. [370]

Mr. Atherton: No dispute on that item. Then the statement continues to state the basis of the Commissioner's determination with respect to the items that are in dispute in the present proceeding. I take it your Honor doesn't wish me to read that.

The Court: No, I think you have read——

Mr. Atherton: Now, if we come to the other deficiency letter, your Honor, it will sort of make the record clear. Referring to Defendant's Exhibit B, your Honor, which is the second deficiency notice, dated June 29, 1938, in which the Commissioner determined an additional deficiency of \$12,657.68 against American Factors with respect to the taxable year ended December 31, 1932, as the statement which is on the second page of that letter shows that the adjusted tax liability as determined by the

Commissioner for the taxable year 1932 was \$75,-096.50.

The Court: Where is that?

Mr. Atherton: That is right in the beginning there, your Honor, right at the beginning, income tax liability.

The Court: Oh, there, yes.

Mr. Atherton: The next column shows assessed \$62,438.82. And the difference between those two amounts carried over to the last column shows the deficiency of \$12,657.68. The statement continues to read as follows:

“The deficiency shown herein is based upon the reports [371] prepared by Revenue Agent H. A. Peterson and L. J. Houghton, copies of which have been furnished you, and other data available to this office.”

The Court: Now let's get to the figures.

Mr. Atherton: Now, on page 2 we show that the return as reported showed a loss of \$80,546.59, instead of a taxable income. Then it shows the adjustments made by the Commissioner which resulted in an adjusted net income of \$546,156.37 instead of net loss. He adjusted it by adding back, that is, eliminating deductions, donations, totaling \$2,225. That is item 1. Item 2, donations, Hawaii Bureau of Governmental Research, \$1,000.

The Court: He struck that out?

Mr. Atherton: He struck that out. Three, litigation costs, \$568,607.76, which is in dispute in this controversy, as well as the preceding item. You see,

in other words, in this letter, your Honor, he not only disallowed what he previously disallowed before, the 480 of the litigation expense, but the additional \$87,000, I believe that was.

Mr. Wild: That's right.

The Court: That would make up——

Mr. Atherton: \$568,607.76. The next item——

The Court: In passing, the American Factors made no claim for the striking out of their Governmental Research?

Mr. Wild: No, your Honor. Unfortunately, we didn't [372] because the law I considered at that time was fairly well-settled. Since that time there have been new authorities and the Government's position has changed. It was a trifling amount and we didn't pay any attention to it.

The Court: Yes.

Mr. Atherton: The next item, then, was the Henry Waterhouse Trust Company adjustment of \$50,000, which is in controversy. And the next three items, the next four items, five, six, seven and eight are not in controversy here.

The Court: Whereas the item classed as number 1, donations——

Mr. Atherton: That is not in controversy.

The Court: Well, it is now?

Mr. Wild: No, that isn't. You mean pensions?

The Court: Pensions.

Mr. Wild: Pensions is in controversy.

The Court: I think the department must have classified the pensions as donations.

Mr. Atherton: Miscellaneous unallowable deductions, that is \$4,063.33. That must be the pension item.

Mr. Wild: That's right.

Mr. Atherton: Yes, that is explained on page 10 of the deficiency notice, your Honor, explanatory item 8.

The Court: I heard nothing about that in that first one.

Mr. Atherton: No, the Commissioner, after he had a [373] second report on this taxpayer's return, after the claim, refund, was filed——

Mr. Wild: What happened there, your Honor, was simply this: I was back before the department and we argued this. The statute of limitations was about to run; the case was extensively settled right there and then; and they asked me to file a claim, waiver of the statute of limitations, and I said I wouldn't recommend my client doing it, that I didn't see any reason why we should. And so they threw the book at me, your Honor, because I wouldn't recommend the client waiving the statute of limitations. They still had several months to go to make up their minds in which to consider it. So they just knocked out everything else that there was in there and sent another letter. That is actually what happened.

Mr. Atherton: Now, your Honor, the letter shows by way of explanation of the Commissioner's adjustments, why he made them. I assume you don't wish me to read any more from that exhibit.

The Court: Maybe you should have stayed away, Mr. Wild.

Mr. Wild: Probably I should have.

The Court: We will take a recess now.

(A recess was taken at 3:13 p.m.)

After Recess

Mr. Atherton: Continuing, your Honor, I'd like to offer in evidence this true photostatic copy of the claim, second [374] claim for refund. I think I previously described it.

Mr. Wild: May I ask a question about the date on that? Isn't that the 22nd?

The Court: Twenty-third, I have it.

Mr. Wild: Well, I have a stamped copy. Our stamped copy is dated the 22nd. But I take it it is the same.

The Court: The date given me was the 23rd, '38.

Mr. Atherton: Well, it doesn't make any difference.

Mr. Wild: It doesn't make any difference. It is that claim, your Honor. And I've got one that was stamped in the revenue office up here, and that is just a photostat.

The Court: That is admitted in evidence as Exhibit E.

(The document referred to was received in evidence as Defendant's Exhibit E.)

Mr. Atherton: And I would like to offer in evi-

dence as Defendant's Exhibit F a true photostatic copy of a letter dated April 22, 1940, addressed by the deputy commissioner of Internal Revenue to American Factors, Limited, notifying the taxpayer that his claim for refund, that is, his second claim for refund of \$16,880.49 referred to here as Defendant's Exhibit E, with respect to the taxable year 1932, has been rejected in its entirety.

Mr. Wild: Yes, it is on account—you read it I think.

Mr. Atherton: Yes.

Mr. Wild: Yes, it said the reason is that a suit is pending [375] in the court. You see, your Honor, the law is, if a claim for refund is filed, as this was, the Commissioner has six months within which he may act on it. If he neither rejects it or accepts it within six months, the taxpayer is then privileged to sue. And I alleged in my complaint that more than six months had elapsed since the claim for refund had been filed, and no action taken by the Commissioners. So I filed a suit. After the suit was filed the rejection letter which is now offered as what—D?—F?

The Court: F.

Mr. Wild: —was sent saying that the claim for refund was denied because suit was pending.

Mr. Atherton: Your Honor, I'd like the record to show that these claims for refund are merely offered for the purpose of showing that the taxpayer filed them and that there is no variance between the allegations contained in the complaint and those

made in the claim for refund, but that there is no admission on the part of the Government that the allegations of fact contained in the claim for refund are true.

(The document referred to was received in evidence as Defendant's Exhibit F.)

Mr. Atherton: I think that concludes the Government's evidence with respect to the American Factors case.

Mr. Wild: Might I ask the Government to stipulate one [376] thing? The H. A. Peterson referred to in the letter was the H. A. Peterson that was here in court?

Mr. Atherton: Yes, I am willing to do that. I don't know why it is pertinent.

Mr. Wild: Well, I don't know that it is. What is your Honor's pleasure about argument to the Court? I have been trying to talk with counsel on all sides to see whether or not we could argue it all out in two hours, two and a quarter hours. That is the time for both sides and in both cases.

Mr. Atherton: There is one thing——

Mr. Wild: Excuse me. I thought you finished the case.

Mr. Atherton: There is one thing I wanted to do. I want to make the motion that I intended to make.

Mr. Wild: I thought you concluded the evidence.

Mr. Atherton: I move, your Honor, that the Government's answer to the complaint herein be deemed to be amended to conform with the evidence and proof adduced at this trial, and that goes with

respect to the American Factors case and the complaint in that case as well as the complaint filed in the Alexander and Baldwin case; and that if there is any question, the Government wishes the record to show that it denies all the allegations of fact contained in the claims for refund referred to in paragraphs 23 and 26, I believe, of the complaint in the American Factors case.

Mr. Wild: I just want to object, your Honor, on the [377] ground——

The Court: Just a moment. You consider an oral motion to amend the answer to be sufficient as a presentation of the thing to the Court?

Mr. Atherton: Well, if your Honor wishes me to do so, I will be glad to prepare a written motion.

The Court: Well, I haven't any preference about the thing but I am asking you if you think that is sufficient?

Mr. Atherton: I don't know that there is any reason to the contrary, but in order to be on the side of safety I ask leave, therefore, your Honor, to file a motion, a written motion to amend the answer.

Mr. Wild: We object, your Honor, to the allowance of the motion. And I don't want to go over all the grounds. May all my grounds as before stated be considered?

The Court: I think I understand your grounds, the nature and exceptions. The motion for leave to amend to conform with the evidence is granted. And you will bring your motion in?

Mr. Wild: May we have an exception, your Honor?

The Court: Yes.

Mr. Wild: And may we have an examination of the proposed amended answer because, your Honor, there isn't any evidence in the case that denies certain allegations that are made in our claims for refund? And in consequence, your Honor, [378] his motion, he now having rested, made this motion, I want an additional chance, then, to object and point out to the Court wherein there is a deficiency in it.

The Court: All right.

Mr. Wild: I don't want to take too much of the Court's time.

The Court: It wouldn't take you too long to analyze his motion?

Mr. Wild: No, your Honor, no.

The Court: And to present your objections?

Mr. Wild: I will do that almost immediately. I don't want to waste any time.

The Court: It is 20 minutes to four now. I haven't got much time. There are other things to be considered between now and Tuesday morning when I will have a jury on my hands with a continual run of jury work day after day. I relied on your estimate that you'd get through by noon with the presentation of the case and get in some argument this afternoon. Now you, Mr. Wild, want about an hour or over——

Mr. Wild: No. I have agreed with counsel that

if he will limit himself to three-quarters of an hour I will limit myself to three-quarters of an hour opening and closing on the Hackfeld litigation case. I felt that that would save the time of the Court, and I think we can cover our subject [379] in that time because our positions are well-known to your Honor now. And your Honor has certainly read these figures here and has them in mind. And I think Mr. Pratt says that he wants a very short time with his argument.

Mr. Pratt: I think perhaps ours won't take more than about 15 minutes, your Honor. We thought also that perhaps it would be wise to submit a written memorandum to the Court.

The Court: Well, I've got a memorandum here from the Plaintiff that was quite useful to me in understanding this; after I read the pleadings, and that with the quite full and comprehensive discussion that was going on here as the evidence was put in, much of which was argumentative and other discussion was instructive to me as to what the case is all about and what the points involved are, that I don't know that I would ask to burden you with any memorandum. Unless there is something that you think that you could emphasize to the Court.

Mr. Pratt: Just a matter of presenting the authorities, your Honor. It wouldn't be an extended memorandum, not in the nature of a long brief but merely discussing certain authorities.

The Court: Unless you discuss authorities, I don't believe it would be much use to me because if

I have to look them up myself, I'd simply have to lay the whole thing on the table for some indefinite time, possibly not before some [380] time next year. I don't want to do it.

Mr. Pratt: Well, if that is so, your Honor, it may take us a little over 15 minutes to cover the whole matter.

The Court: I don't want to limit you in your argument.

Mr. Wild: I expected that the Government would file one at the same time when we did. But I thought I had laid out pretty well the legal bases. I didn't discuss the cases much but I laid out the legal bases for guidance, as we went along. And do I get the idea now that your Honor feels that I should supplement that at all by further statement of the cases in writing?

The Court: I'd just as soon you do it in argument.

Mr. Wild: Very well, your Honor.

The Court: Have you got anything in writing, Mr. Atherton?

Mr. Atherton: Yes, I have a memorandum, your Honor, in writing.

The Court: All right, now.

Mr. Atherton: It is all ready. It doesn't cover the point of restitution,—I was going to say retribution—restitution, that my worthy opponent has introduced in his memorandum, a restatement of the law. I haven't got the restatement here and I would like an opportunity to supplement this memorandum by another one after I get back to Washington.

Mr. Wild: May we have a copy of that? [381]

Mr. Atherton: Because this isn't complete on every angle. It misses that. But it is complete in every other respect.

The Court: Can't you give me your other angles in your argument?

Mr. Atherton: Well, I can do my best orally about it, but it is not going to be altogether satisfactory to me and probably not too satisfactory to my office. I have to think of what the policy is in the office. That is unfortunate.

The Court: I know, but you have to take into consideration that this is a trial court, though, and a rather busy one. We don't have the time that the appellate court has, to go into our chambers and send our clerks for books all marked and ready to read. We don't have any law clerk to help us and to come in and dump half a hundred authorities in the judge's lap and say, here's your authority for this, that and something else. It just can't be done. We can't keep up with it.

Mr. Atherton: Well, I will file this memorandum with your Honor. It has been revised.

The Court: Well, I will read that overnight. I took home a 138-page brief last night and got myself to sleep with it.

Mr. Wild: Well, I would like to be furnished with a conformed copy. I gave counsel a statement of our position [382] at the outset. He has had the benefit of that as we had gone along, and I'd like to see what his position is as stated there, at least a little while before we have the argument.

Mr. Atherton: Well, I haven't got it prepared. You know there is quite a shortage of stenographic help in the United States Attorney's office. One of those young ladies worked here a couple of nights with me in trying to get these pages rewritten, and the carbons haven't been conformed to the copy that I am handing, all except one, and I have the one in my possession.

Mr. Wild: I think we are entitled to that one.

The Court: When can we get to argument?

Mr. Wild: Well, what is your Honor's pleasure?

The Court: My pleasure would be to go ahead tomorrow morning, but I can see that you are not all prepared.

Mr. Wild: I am prepared, your Honor, but I do think that I am entitled to see the Government's position before we argue. If your Honor would rather have it over the week-end, I will go right ahead tomorrow morning, if your Honor wishes, but I would like to get it tonight before that argument, his position so that I can analyze his cases. I think I know some of the cases he is going to cite and I think, your Honor, I can distinguish them offhand but I am not sure.

The Court: Well, suppose, then, Mr. Atherton, you let Mr. Wild have your memorandum that you have prepared, with [383] the understanding that he get it to me by tomorrow evening so that I can work on it, read it and consider it.

Mr. Wild: You mean the one that was filed with your Honor?

The Court: This one that hasn't been filed.

Mr. Wild: Oh, yes.

The Court: There has been nothing filed.

Mr. Wild: I thought he presented it. Yes, he has one.

Mr. Atherton: I was going to do this. I think it would be better, so we can go on with argument tomorrow morning.

The Court: No—well, go ahead.

Mr. Atherton: I will hand you my only copy and I will rely on my previous memorandum and let the Judge have the original, the original of the revised copy, and then that will put you in a position where you will know what I am going to talk about.

Mr. Wild: Well, the Judge said he'd prefer not to argue tomorrow.

Mr. Atherton: I will get the revised copy to him.

Mr. Wild: Well, if the Judge isn't going to argue tomorrow, then if I can borrow the other, you can make the other revisions and hand that to the Judge by tomorrow noon or tomorrow night.

Mr. Atherton: I was trying to get the case for argument tomorrow so that we can get it over with. That's what I was [384] trying to do. I want to do everything I can to help your Honor to get the case on tomorrow so we can finish it up.

The Court: Well, I am slightly apprehensive this way, that I don't want either side to feel that they are being hurried and denied every opportunity that they should have to be fully prepared for argument,

because I have got to fashion what I can, and when I have heard all of the case and heard the argument I generally have my mind made up, make it up then, because I can't carry too many of these things for weeks. And it may result in carrying them for months. And that means it will simply go through a record that requires a week or two and then doing it all over again. With the backlog that the reporter has, it will take him a month before he can give me a transcript.

Mr. Wild: Well, when did your Honor want to have it argued, tomorrow morning or when, your Honor?

The Court: Would you all be ready tomorrow morning?

Mr. Wild: I hope to be.

Mr. Pratt: We can be ready, your Honor.

The Court: Well, tomorrow is my day off and I've got another appointment.

Mr. Wild: If your Honor would rather prefer it Monday——

The Court: Well, I've got so many things to think about Monday. Let's make it tomorrow. What time do you want to start? [385]

Mr. Wild: What time would your Honor care— 10 o'clock?

The Court: What time do you want?

Mr. Atherton: Ten o'clock is agreeable to me.

The Court: That would run it until about one o'clock?

Mr. Wild: Well, as I understood it, we confine

ourselves to an hour a piece. I have no more than an hour on opening and closing. And the Government will have no more than an hour in their argument. Then there would be 15 minutes and 15 minutes. That would be half an hour. So that would be two hours and one-half. That would be about 12:30.

The Court: Do you want to commence half past nine?

Mr. Wild: Well, you see, counsel has had the benefit of seeing my cases for a week now. I haven't even seen his. And I would like a minute, your Honor, just to take a look. I think I know the cases he has cited and I think I can distinguish the ones that should be distinguished, but I am not positive until I see them, your Honor. And if I can see it tonight, why——

Mr. Atherton: I will show it to him tonight.

The Court: All right. Ten o'clock tomorrow.

(The Court adjourned at 3:55 p.m.) [386]

November 15, 1947

(Court convened at 10:00 a.m.)

The Clerk: Civil No. 419, American Factors, Limited, versus Fred H. Kanne; case called for argument.

Mr. Wild: Ready for the Plaintiff.

Mr. Atherton: Ready for the Defendant, your Honor. The Defendant has a written motion to amend its answer to conform to the evidence, together with a memorandum of points of authorities

which we would like to file now with the Court, your Honor.

The Court: Has opposing counsel seen it?

Mr. Wild: No, your Honor. I am just getting a copy.

Mr. Atherton: Shall I read the motion, your Honor?

The Court: Yes.

(Mr. Atherton read the documents referred to.)

(Mr. Atherton presented argument on the motion to amend Government's answer.)

The Court: Well, as near as I can tell, everything that was brought in issue has been either admitted or denied. I believe that the Defendant is entitled to amend his answer, which of course would be an amendment *Nunc pro tunc*. I can see nothing injurious to the Plaintiff in the amendment, in view of what has gone on here this morning. The motion to amend is granted. [387]

Mr. Wild: May we have an exception, your Honor?

The Court: Let an exception be noted in the record.

(Mr. Wild presented the argument on behalf of the Plaintiff.)

(Mr. Pratt presented the argument on behalf of Alexander and Baldwin, Limited.)

Mr. Wild: Your Honor, might I ask that that argument may be considered also as part of our argument?

The Court: Yes.

(The Court recessed at 12:15 p.m.)

After Recess

(Mr. Atherton presented the argument on behalf of the Defendant.)

(Mr. Pratt presented the closing argument on behalf of Alexander and Baldwin, Limited.)

(Mr. Wild presented the closing argument on behalf of the Plaintiff.)

(Mr. Atherton presented his reply argument on behalf of the Defendant.)

The Court: As to the American Factors, Limited——

1. Hackfeld Litigation: My opinion is that the persons who subscribed to pay voluntarily for the defense of this inordinately costly litigation were impulsed and motivated entirely by keen personal desires to defeat the demands of [388] the plaintiffs in the case and clear themselves as defendants against claims that they had unlawfully conspired and acted in fraud and greed, as well as to escape a liability in damages by a possible judgment against them and to protect their individual investments as shareholders in the corporation, and that they were

willing and made a definite offer to pay, and did pay to the extent of assessments made against them, without promise or original expectation of reimbursement at the time and times they made their contributions to the litigation fund.

There is no evidence that the taxpayer promised or implied an intention to reimburse them at the time they subscribed or made their contributions, and no evidence that the taxpayer even considered the matter until the backbone of the litigation was broken in victory to all the defendants.

There was no demand by them or test of their right to have contribution at the expense of other shareholders who were not named as parties defendant. The approval at a stockholders' meeting and the act of the management in reimbursing these contributors from the company's funds apparently flowed largely from feelings of gratitude arising from the successful outcome of the case in litigation and the liberal aid of the contributors and their steering committee which contributed many facilities and influences such as could not have been supplied by the management of American [389] Factors acting alone.

Certainly, the taxpayer had very substantial interests to protect, and was justified in every way as a legitimate business outlay, in paying from its own funds during the taxable year of 1932, or earlier years had it chosen to do so, the costs of litigation which imperiled its existence, although others were involved in the same litigation as defendants and

had much to lose, had the others not come forward with funds and volunteered to engineer and fight the battle at their own costs and had the taxpayer not accepted this offered payment-plan and the volunteered services; either of the parties could have abandoned or modified this plan at any time, but so long as it was adhered to it was binding on both; but the taxpayer was not justified, in the realm of taxation laws and deductibles, to later deduct from taxable income the money it paid to reimburse voluntary contributors for money which they had paid out to clear themselves of fraudulent charges made against them collectively and individually and to protect their property interests, no matter if victory in such defense brought great benefit to the taxpayers as well as to the other named defendants.

As between share owners, of course, within ultra vires limitations, they were empowered to make any desired distribution of the company's funds so long as none was injured.

The taxpayer is entitled to an expense-deduction in its [390] 1932 tax return of the sum of all Hackfeld Litigation paid by it prior to the end of 1932, less the amount paid in to it for that purpose by the other defendants.

2. As to the Waterhouse Trust Company contribution of \$50,000, this was just that—a contribution. The note given in acknowledgment of the contribution was contingent as to value upon such conditions as to give it no negotiable value from the time it was made. It could not be dealt with as a

debt. The considerations in payment for the contribution flowed to the payee at the time it was made—the protection of the commercial community, sympathy toward Waterhouse Company clients who could ill afford to lose, and other commendable desires and motives of helpfulness and security, but there was no attempt to show that either American Factors or Alexander and Baldwin would have suffered any loss had they not attempted to keep the Waterhouse Trust Company a going concern.

I find that no part of this contribution was deductible as a bad debt or loss in 1932 or at any other time since it never was a collectible debt, but was from the beginning in the nature of a contingent or speculative gift, to which status it speedily resolved itself with certainty, although it may have accomplished in part the purpose for which it was intended, that is, prolonged the life of Waterhouse Trust Company. [391]

3. As to the items of contributions or pensions to dependents of deceased employees, I am fully convinced from the evidence that this was a usual and, within ordinary business discretion, a necessary and proper business practice. It is well recognized that it would reasonably tend to the gratification, good will and loyalty of employees in general and thus be a benefit to business operations, particularly in a business under many department heads and of ramified operations.

I find these items to be proper income tax deductions.

Alexander and Baldwin, Limited:

1. My opinion and finding with respect to the Waterhouse Trust contribution in the American Factors case is, in all pertinent respects, applicable to the refund claim of this litigant and the said claim is denied.

2. As to the contribution to maintain the Hawaiian Bureau of Governmental Research, I find this to be an ordinary and necessary expense to a firm carrying on the business and business trusts and responsibilities such as Alexander and Baldwin carry.

If more extensive findings and conclusions are desired, the prevailing parties may prepare and submit such proposals to me, after tendering copies to opposing counsel.

Mr. Wild: Your Honor, on behalf of American Factors may we except to the ruling of the Court that the amount of [392] \$396,812.50 is not an allowable item of deduction, and for failure of the Court to rule that if it wasn't an allowable deduction for the particular year then that it was an additional amount attributable as a deferred payment to the cost of the assets and business of the company? May we also have an exception, Your Honor, to the denial——

The Court: Don't go too fast because this is the only record you've got.

Mr. Wild: An exception to the findings of the Court concerning the Henry Waterhouse Trust

Company note. And may it be understood that there are a good many other points of exception that I would like to make? One is that there is no evidence in this case that shows on the first issue that the persons who subscribed for and paid this fund did so without any expectation of reimbursement if the litigation was successful. On the additional ground that the Court has failed to recognize the rule of law under which restitution was required under the facts of the case, even though there was no agreement or understanding between American Factors and the other parties that this amount should be returned.

And on the further ground that the decision of the Court fails to take into consideration the fact that to permit American Factors to keep for itself the benefit of the payment of \$396,812.50 of the litigation expenses under these circumstances [393] amounts to an unjust enrichment of American Factors which under the circumstances of this case it was obligated in 1932 to make restitution of to the other 23 defendants.

I think that covers it all, Your Honor.

The Court: Well, you may add anything to it that you want, that you give further thought to.

Mr. Bortz: Your Honor, I'd like to note for the purpose of the record an exception to the findings incorporated in paragraph 1 in behalf of Alexander and Baldwin.

The Court: Under Alexander and Baldwin, yes.

Mr. Wild: With the permission of the Court I

would like to add to my former exceptions the old stock one, that the opinion of the Court concerning the \$396,812.50 item in the Hackfeld litigation expense item is contrary to the law, contrary to the evidence, is contrary to the weight of the evidence, and that there is no evidence in this record to support the statement that the persons subscribed voluntarily, were impulsed and motivated entirely by keen personal desires to defeat the demands of the plaintiffs in the case and clear themselves as defendants against claims that they had unlawfully conspired and acted in fraud and greed, as well as to escape a liability in damages by a possible judgment against them and to protect their individual investments as shareholders in the corporation.

The Court: Of course that is a conclusion drawn from [394] the evidence.

Mr. Wild: Well, I say that there is no evidence which supports the conclusion that these men were impulsed and motivated entirely by keen personal desires to defeat the demands of the plaintiff. It is our contention that on the record, as a matter of law, they were impulsed and motivated by the fact that they knew if the charges were accurate they were liable, and that they therefore depended on that. And I think there is no evidence to support that, Your Honor.

The Court: I gathered that largely from that agreement there entered into.

Mr. Wild: But the agreement, Your Honor, says nothing about that.

The Court: Well, I could be wrong there.

Mr. Wild: And further on the ground that there is evidence in the case that the taxpayer promised or implied an intention to reimburse them at the time they subscribed or made their contributions, arising from the facts and circumstances and the law applicable thereto, and stated in the theories of restitution under unjust enrichment; that the agreement arises not because of any promise made, oral or in writing, but by virtue of the circumstances and lays the foundation for a claim. And on the further ground—no, I think I have stated that. I think I have stated all my grounds. [395]

The Court: Well, you may take another turn at it.

Mr. Atherton: Your Honor, may I ask for a matter of information, this statement here on page 3, it says, "The taxpayer is entitled to an expense-deduction in its 1932 tax return of the sum of all Hackfeld Litigation paid by it prior to the end of 1932, less the amount paid in to it for that purpose by the other defendants." In other words, do I take it from that that you are allowing the taxpayer a deduction of \$171,000?

The Court: As to the figures, I am not certain. I couldn't carry them so well. But they paid out a gross sum, and they received from the other defendants; it was their contribution. Now, the difference between what they paid out and what they received from the other defendants by way of contribution, that if it was accrued prior to the taxable year 1932,

I hold they are entitled to recover by way of deduction.

Mr. Atherton: In 1932?

The Court: Yes. Does that express the sense——

Mr. Atherton: Yes, it explains it. That's the way I have visualized it. It is the difference between the 396 and the 568.

The Court: That's right. I haven't figured it out.

Mr. Atherton: I want to say here with respect to the remarks made by Mr. Wild after you handed down your written [396] opinion, I think that they should be expunged from the record. All that goes to the appeal, if he wants to take an appeal. The case is closed now.

The Court: I don't follow you there. Now he takes an exception to these brief findings and the opinion in spots, and he sets out in the record the basis for his objections. I think that is perfectly proper.

Mr. Wild: It has always been our practice, Your Honor.

Mr. Atherton: What I had in mind, supposing I had to return to Washington and you had written this opinion a month or two later.

The Court: I probably would hand you a better-finished article, but I want to get through with the case.

Mr. Atherton: I am much pleased with it myself, personally. But what I mean is, I have never yet in any cases I have appeared in for the Government

ever interposed at the conclusion of the case, after the judge had rendered his opinion from the bench—and it has happened down in Texas several times—any exception by the Government, although the decision had been against the Government. I never heard counsel for the other side ever do so. It strikes me as an extraordinary presentation, that if he wants to take an appeal he should notice his appeal.

Mr. Wild: We can't note an appeal from the decision, as you know. If rendered in open court, we state our objections [397] and take our exceptions. That's all. It has always been our practice.

The Court: It is my opinion that that is proper.

Mr. Atherton: Well, if that is so, then I, as a matter of record, I'd like the record to show that the Government takes exception to the last paragraph of your finding No. 1 with respect to the Hackfeld litigation expense insofar as it allows as a deduction to the American Factors corporation in the year 1932 for tax purposes the sum of \$83,812.50, I believe, which represented that part of the Hackfeld litigation expense incurred and paid prior to the taxable year 1932. And with respect to the balance, as well as that that the Government takes exception, to the allowance of any part of the litigation expense on the ground that it did not represent ordinary and necessary expense of doing business by American Factors.

Now, as to the item in paragraph 3, No. 3 of your findings, Your Honor, respecting the contributions

of pensions, the Government wishes to register its exception to that finding and the same with respect to the finding No. 2 under the Alexander and Baldwin, Limited, case concerning the contributions to the Hawaiian Bureau of Governmental Research.

And I want to thank you personally for your patience.

The Court: It is hardly appropriate for me to say that you are welcome, because that is what I am here for. [398]

Mr. Wild: I must say, Your Honor, you have been very patient in dealing with us. We have certainly taken up all your time on Saturday afternoon.

The Court: Now, Mr. Atherton, you, upon the whole and largest measure, seem to be representing the prevailing party. I am going to call on you to prepare appropriate findings and conclusions.

Mr. Atherton: I will try and get them out. I will start on them Monday.

The Court: When you do, submit a copy to your esteemed antagonist, both of them, and they may have something to say and they may want findings, they may want to submit findings of their own design.

Mr. Wild: Yes, Your Honor, we might.

The Court: And the Court will entertain all those in due course. Now, is there anything more before the Court at this time? Is there? The Court stands adjourned until Monday morning.

(The Court adjourned at 4:45 p.m.) [399]

CERTIFICATE

I, Albert Grain, Official Court Reporter, U. S. District Court, Honolulu, T. H., do hereby certify that the foregoing is a true and correct transcript of proceedings reported by me in Civil No. 419, American Factors, Ltd. versus Fred H. Kanne, and Civil No. 474, Alexander and Baldwin, Ltd. versus Fred H. Kanne; proceedings held in the above-named court on November 12, 13, 14, 15, 1947, before the Hon. Delbert E. Metzger, Judge.

Nov. 26, 1949.

/s/ ALBERT GRAIN.

[Endorsed]: Filed December 8, 1949.

[Endorsed]: No. 12391. United States Court of Appeals for the Ninth Circuit. Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii, Appellant, vs. American Factors, Limited, an Hawaiian corporation, Appellee-Appellant, and vs. American Factors, Limited, an Hawaiian corporation, Appellant, vs. Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii, Appellee. Transcript of Record. Appeals from the United States District Court for the District of Hawaii.

Filed November 2, 1949.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals
For the Ninth Circuit

No. 12391

AMERICAN FACTORS, LIMITED, an Hawaiian
corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix under the Will and
of the Estate of Fred H. Kanne, Collector of
Internal Revenue of the United States for the
District of Hawaii,

Defendant.

STATEMENT OF POINTS TO BE
RELIED UPON

Comes now, American Factors, Limited, the plaintiff in the above entitled cause, and states that the points upon which it intends to rely in its appeal are as follows:

The United States District Court for the Territory of Hawaii erred:

1. In concluding that plaintiff is entitled to a deduction of only \$171,795.26 instead of \$568,607.76 of the Hackfeld litigation expenses as ordinary and necessary expenses paid or incurred during the taxable year 1932;

2. In concluding that \$396,812.50 of the Hackfeld litigation expenses, which plaintiff refunded or

repaid in the year 1932 to persons and corporations who were codefendants with plaintiff in said litigation, were not ordinary or necessary expenses paid or incurred during the year 1932;

3. In failing to find and hold that the Commissioner of Internal Revenue erred in disallowing plaintiff a deduction of \$568,607.76 of the Hackfeld litigation expenses in computing its net taxable income for the year 1932;

4. In concluding that there was no legal obligation or liability on the part of the plaintiff to reimburse or refund to its stockholders who were codefendants with it in the Hackfeld litigation, the sum of \$396,812.50 which plaintiff repaid to them in 1932;

5. In failing to find and hold that even in the absence of any legal obligation or liability on the part of the plaintiff to reimburse or refund to its stockholders who were codefendants with it in the Hackfeld litigation, the refund or repayment to them was nevertheless an ordinary and necessary expense of the plaintiff paid or incurred during the year 1932;

6. In concluding that the payment of \$50,000.00 to the Henry Waterhouse Trust Company, Limited, in 1931, by plaintiff, was just a contribution;

7. In concluding that the note given by Henry Waterhouse Trust Company, Limited, in 1931, to the plaintiff, was contingent in payment; was subject to such conditions as to render it nonnegotiable,

and was without any negotiable value at the time it was made and at all times thereafter;

8. In concluding that the note given by Henry Waterhouse Trust Company, Limited, in 1931, to the plaintiff, could not be dealt with as a debt;

9. In concluding that the contingencies as to payment and/or the lack of negotiable value prevented said note from being evidence of a debt;

10. In concluding that the Commissioner of Internal Revenue did not err in disallowing plaintiff a deduction therefor as a bad debt in computing its taxable net income for the calendar year 1932;

11. In concluding that no part of the payment of \$50,000.00 made to Henry Waterhouse Trust Company, Limited, in 1931, by plaintiff, was deductible as a bad debt ascertained to be worthless and charged off within the tax year 1932, or as a loss sustained during that taxable year;

12. In failing to render judgment in favor of the plaintiff for the amount of \$97,134.90 instead of the amount of \$31,691.18 on account of plaintiff's overpayment of income tax for the year 1932.

Dated: Honolulu, T. H., November 1, 1949.

SMITH, WILD, BEEBE
& CADES,

By /s/ MILTON CADES,

Attorneys for American
Factors, Limited, Plaintiff.

[Endorsed]: Filed November 2, 1949.

[Title of Court of Appeals and Cause.]

DEFENDANT - APPELLANT'S STATEMENT
OF POINTS ON APPEAL PURSUANT TO
RULE 19

1. The court erred in concluding that Plaintiff-Appellant is entitled to a deduction of \$171,795.26, or any part thereof of the Hackfeld litigation expenses as ordinary and necessary expenses paid or incurred during the taxable year 1932.

2. The court erred in concluding that the Commissioner of Internal Revenue erred in disallowing the Plaintiff-Appellant a deduction for the amount of \$171,795.26, or any part thereof, of the Hackfeld litigation expenses in computing its taxable net income for the year 1932.

3. The court erred in failing to find and hold that all of the Hackfeld litigation expenses had been incurred and had accrued prior to the taxable year 1932.

4. The court erred in failing to find, in accordance with the stipulation of facts No. II, that all of the Hackfeld litigation expenses, except \$87,992.50, were actually paid prior to the year 1932.

5. The court erred in holding that the Plaintiff-Appellant was entitled to recover any income tax paid by it for the taxable year 1932 attributable to the denial of the deduction of the Hackfeld litigation expenses.

6. The court erred in rendering judgment in favor of the Plaintiff-Appellant in any amount in excess of the overpayment of income tax for the year 1932 attributable to the deduction for payments made to dependents of deceased employees.

Dated: Honolulu, T. H., this 31st day of October, 1949.

/s/ RAY J. O'BRIEN,

Attorney for the United States, District of Hawaii,
Attorneys for Agnes M. Kanne, Executrix
under the Will and of the Estate of Fred H.
Kanne, Collector of Internal Revenue of the
United States for the District of Hawaii, De-
fendant-Appellant.

[Title of Court of Appeals and Cause.]

STIPULATION AS TO DESIGNATION OF
RECORD TO BE PRINTED

Pursuant to Rule 19 of this Court Plaintiff-Appellant and Defendant-Appellant hereby designate for printing the following portions of the record on appeal. (References in the left-hand column are to item numbers as set forth in the designation of the record on appeal.)

1. Complaint;
2. Defendant's original Answer;

3. Motion to Substitute Executrix as Defendant, with Consent of Executrix;

4. Defendant's Motion to Amend her original Answer to Conform with the Evidence, filed November 17, 1947;

5. Transcript of testimony of S. M. Lowrey, H. C. Eichelberger, W. T. Vorfeld, T. G. Singlehurst, E. J. Greaney, A. L. Castle, A. L. Dean, and C. R. Linden;

6. Exhibits P-5, P-6, P-7, P-8, P-9, P-10, P-11 and P-13;

7. Statement of points to be relied on by Plaintiff-Appellant on Appeal;

8. Statement of points to be relied on by Defendant-Appellant on Appeal;

9. Complete docket entries;

10. The Opinion of the Court, filed March 18, 1948;

11. The Court's Findings of Fact and Conclusions of Law;

12. Judgment Order of Court;

13. Certificate of Probable Cause;

14. Copies of Notices of Appeal;

15. Bond for Costs of Appeal;

16. Stipulation Extending Time to File Transcripts of Record on Appeals.

17. Stipulation Further Extending Time for Filing Record on Appeal and Docketing Appeal.

Dated: Honolulu, T. H., October 31, 1949.

/s/ RAY J. O'BRIEN,
United States Attorney, District of Hawaii, At-
torney for Defendant-Appellant.

SMITH, WILD, BEEBE
& CADES,

By /s/ MILTON CADES,
Attorneys for Plaintiff-
Appellant.

[Endorsed]: Filed November 2, 1949.

[Title of Court of Appeals and Cause.]

STIPULATION EXTENDING TIME FOR FIL-
ING RECORD ON APPEAL AND DOCKET-
ING APPEAL

It is hereby stipulated and agreed by and between the attorneys for the respective parties herein, on the basis of the affidavits attached hereto, that both the Plaintiff-Appellant and the Defendant-Appellant may have to and including the 18th day

of November, 1949 within which to file the record on appeal and docket the appeal.

Dated: Honolulu, T. H., this 31st day of October, 1949.

/s/ RAY J. O'BRIEN,
United States Attorney, District of Hawaii, Attor-
ney for Defendant-Appellant.

/s/ MILTON CADES,
SMITH, WILD, BEEBE
& CADES,
Attorney for Plaintiff-
Appellant.

Approved:

.....,
Judge, United States Court of
Appeals, Ninth Circuit.

So Ordered:

/s/ WILLIAM HEALY,
Chief Judge.

/s/ HOMER T. BONE,

/s/ MARVIN L. POPE,
United States Circuit Judge.

[Endorsed]: Filed November 4, 1949.